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Mediation in the Context of (Approaching) Insolvency: A Review on the Global Upswing by N. Pavlova Mocheva and A.R. Shah

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Mediation in the Context of (Approaching) Insolvency: A Review on the Global Upswing

Nina Mocheva, Angana Shah

Executive Summary

The use of mediation to enhance the possibility of business restructuring in the face of financial distress or the success of ongoing court insolvency proceedings has been increasing worldwide. The benefits have been many and multi-faceted, which has prompted many developing countries to provide for the use of mediation in their recent insolvency law reforms. It is most longstanding in the United States, where bankruptcy courts often mandate mediation of certain motions to streamline administration. Its use is growing in Europe, particularly for preliminary or out of court procedures aimed at preventing insolvency. In Asia, mediation was introduced as part of many debt restructuring systems created in response to the late 1990s Asian financial crises; the use of mediation in these systems has continued and increased in recent years. In emerging market economies, undertaking insolvency reform, or introducing their first insolvency laws, mediation is becoming a common part of the regime. For large transnational cases, mediation has allowed several high-profile cases to be completed successfully, at lower cost than fully-fledged litigation, with greater recovery for creditors. If utilized properly, mediation can lower the costs of administration of insolvency, and thereby increase the recovery to creditors. At the same time, if it is unsuccessful, it poses risks for prolonging proceedings and asset deterioration during the negotiation period. Specially trained mediators may be able to assist parties in compromising on formerly entrenched positions in disputes. When acting as advisors, as well as conventional mediators, they can assist in the preparation of the restructuring plan itself. Mediation has been gaining traction as part of restructuring and insolvency proceedings, both in and outside of courts, and has become a “best practice” feature for modern insolvency reform.

I. Introduction

The use of mediation in insolvency has been spreading worldwide. In the United States, the use of mediation during court insolvency proceedings has been established for some time¹. In fact, going beyond ad hoc use by parties, the Delaware U.S. bankruptcy courts have mandated the use of mediation for certain groups of cases such as preference actions and adversary proceedings.² In New Jersey, the bankruptcy courts have rules setting forth a presumptive referral of all adversary proceedings or contested matters to mediation.³ The uptake of mediation in the context of pre-insolvency and insolvency proceedings has been slower in Europe, as mediation is “younger” there.⁴ It is undeniably gaining more and more

¹ Bob Wessels, “Mediation in Restructuring in Insolvency”, *Eurofenix*, Spring 2016, available at <http://www.insolventmediation.nl/media/uploads/file/3.%20Mediation%20in%20Restructuring%20and%20Insolvency%2C%20Eurofenix-63-Mediation-002.pdf>

² Marcos A. Ramos, “Delaware Bankruptcy Court: Mandatory Mediation Update”, *Bankruptcy & Insolvency Litigation*, American Bar Association, Spring 2013, Vol. 18 No. 3. Available at http://www.rlf.com/files/7006_Ramos_delaware_bankruptcy_court.pdf

³ Peter F. Philips, “Mandatory Mediation Initiative at the Bankruptcy Court for the District of New Jersey”, March 20, 2014, available at <http://www.businessconflictmanagement.com/blog/2014/03/mandatory-mediation-initiative-at-the-bankruptcy-court-for-the-district-of-new-jersey/>

⁴ *Supra note 1.*

traction. So much so that the European Commission issued a Recommendation that suggests to Member States that they create pre-insolvency procedures aimed at assisting debtors in restructuring outside of the courts, and that they allow their courts to appoint mediators where requested by a party, in order to facilitate the adoption of a restructuring plan, to avoid insolvency.⁵ The successful and visible use of mediation in cross-border cases such as Lehman Brothers, as a case management tool, to resolve hundreds of cases without litigation, augurs well for the continuing growth of mediation in insolvency.

The benefits of mediation in insolvency are multi-faceted. As indicated, mediation can be applied to large pools of claims, such as it was in the Lehman Brothers case for derivatives claims, to resolve such claims more rapidly, and at much lower cost than if each claim was litigated, leading to greater recovery for creditors through drastically lower administrative costs. A mediator can also serve as the facilitator between debtors and creditors for the restructuring plan itself; this particularly tends to be undertaken in pre-insolvency procedures aimed at preventing bankruptcy filing, that are set forth in several European countries' laws. If it is implemented at the court level, to apply regularly to cases rather than an ad hoc approach, it can improve case management if mediation of the designated types of cases (preferences and adversary proceedings in some courts in the U.S.) resolves them more quickly and at lower cost than litigation.⁶ It can also be particularly useful when mediators with specialized knowledge facilitate negotiations involving small businesses and individual debtors, who may not have the capacity and knowledge on their own to successfully negotiate agreements with creditors to relieve overburdening debt. The use of mediation in insolvency and restructuring in the different countries' systems and to different cases is discussed below, along with examples of the benefits of each use.

II. Mediation in Support of Pre-Insolvency Negotiations Between Debtors and Creditors

Pre-insolvency procedures occur before an insolvency filing, or before the debtor is declared bankrupt, to allow the debtor a chance to rehabilitate in the pre-insolvency stage and avoid bankruptcy proceedings⁷. As insolvency laws continue to be reformed, more and more countries are including procedures that are intended to bring a debtor and its creditors to the negotiating table at a relatively early stage of financial distress, in order to maximize the chance of rehabilitation, and prevent a full insolvency proceeding. The above-referenced European Commission Recommendation to Member States for the provision of pre-insolvency restructuring options within the corporate insolvency regime can be read as acknowledgement of pre-insolvency regimes already adopted in some Member States, and

⁵ "Commission Staff Working Document Impact Assessment accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency", (2014) 1500 final, SWD (2014) 62 final, Brussels, March 12, 2014, available at http://ec.europa.eu/justice/civil/files/swd_2014_61_en.pdf.

⁶ If the mediation is not effective, but mandated, it can become just another procedural hurdle to making progress in the case. The European Commission's "Commission Staff Working Document" that accompanies the recent EC Recommendation on insolvency discussed above, suggests that this fear as the reason that the Recommendation embraces voluntary but not mandatory mediation.

⁷ For purposes of this article, we have adopted the definition of pre-insolvency or "early intervention" procedures from the 2016 European Commission proposal for a Directive (which is a follow-up to its 2014 Recommendation on a new approach to business failure and insolvency), which describes them as hybrid "quasi-collective" procedures since they combine informal creditor negotiations with limited supervision of a court or administrative authority (typically at the beginning and/or end of the proceedings). The defining feature of pre-insolvency procedures is that they give debtors an opportunity to restructure at the pre-insolvency stage and avoid the commencement of insolvency proceedings.

encouragement for the adoption of more to maximize their impact. The procedures vary across countries. In some countries, such as in France, courts appoint mediators to facilitate the process. In contrast, in Ireland an “examiner”, who is a trained insolvency practitioner, oversees the pre-insolvency restructuring. The use of mediators in pre-insolvency procedures is discussed below with examples.

A. Mediation of Two-Party Disputes to Prevent Insolvency

Mediation is used pursuant to some countries’ insolvency laws to settle two-party disputes in order to prevent a full bankruptcy proceeding. In several countries with less-developed insolvency practice, insolvency remains a largely one creditor-one debtor action; a debt collection action rather than a collective process involving multiple creditors. The creditor files for insolvency to motivate the debtor to pay an outstanding debt, before the initiation of insolvency proceedings. The insolvency petition is used as a threat, a tool to compel payment. In such countries, the collective insolvency proceeding has not become common, as the typical case is either resolved through voluntary payment, seizure of assets by the creditor, or little or no payment to the creditor due to lack of assets. These cases can languish indefinitely without resolution through procedural delays. In these countries, ADR, specifically mediation, has been incorporated into the law as a mechanism to prevent such disputes from triggering insolvency proceedings. The reasoning is, that if it is a two-party dispute, and the debt can be resolved, the insolvency proceeding will not be needed. In Armenia, for example, alternative dispute resolution (ADR) is used to resolve disputes between banks and their borrowers that may otherwise lead to insolvency filings.⁸ Article 18 of the insolvency law allows for conciliation between two parties. However, for a collective settlement among creditors, the full recovery proceeding is required⁹, suggesting that conciliation may resolve the dispute leading to insolvency if it remains between two parties but not once the case has the potential to affect third parties. Even if there are multiple creditors, a country may allow mediation aimed at dismissal of the bankruptcy petition, as in Singapore. In Singapore, the Official Assignee, the public bankruptcy trustee, provides mediation services through the Bankruptcy Mediation Unit. Creditors are encouraged to engage in mediation before resorting to bankruptcy, in an effort to prevent a bankruptcy filing.¹⁰ In Vietnam, a debtor may petition within 3 days of the filing for negotiation with creditors; the goal of the negotiation is withdrawal of the petition.¹¹ In contrast, when the purpose is to support a collective solution between a debtor and multiple creditors, mediation is used to facilitate the collective proceeding.

B. Facilitation of a Restructuring Plan among Debtor and Multiple Creditors

In a collective proceeding with multiple creditors, mediation can facilitate either a full settlement among all creditors or among several large creditors in the context of a pre-insolvency procedure aimed at allowing the debtor’s rehabilitation. It can be used with all or most of the creditors to create a plan of rehabilitation for the debtor, or used to settle individual disputes that may otherwise hold up the insolvency proceeding with time-

⁸ Interviews with banks during a World Bank Group mission to Armenia in 2014.

⁹ Law of the Republic of Armenia on Bankruptcy, Article 18.

¹⁰ “Bankruptcy and Insolvency”, document in *Law Society of Singapore Community Legal Clinic Manual*, Version 4.04 – Compiled on April 2015, at <http://lawsoc-clinic-manual.readthedocs.io/en/latest/sections/bankruptcy-and-insolvency.html>

¹¹ Allens-Robert Fish, “Vietnam legal update: new Law on Bankruptcy to take effect in January”, December 22, 2014, at <http://www.lexology.com/library/detail.aspx?g=0c900181-7bea-4673-94c7-9c780cddd9af>.

consuming and costly litigation. The earlier that a financially distressed debtor attempts to work with creditors and restructure his debts, the better chance there is for the company to be rehabilitated. Worldwide, countries are implementing or enhancing pre-insolvency procedures aimed at preventing bankruptcy through the use of mediation, among other tools. Many are untested, since the reforms were recently passed and are still being implemented, but the trend reflects a recognition of the potential for mediation to enhance the possibilities of rehabilitation of a financially distressed debtor. For example, Cabo Verde in Africa similarly has untested pre-insolvency provisions in its new 2016 insolvency law, which provides for an out-of-court pre-insolvency proceeding as a mediation procedure that is to be initiated during imminent or threatened insolvency. It appears from the provisions that in addition to the debtor's commercial creditors, social security and tax creditors are required to participate in the mediation process, although their ability to settle claims may be constrained by other legislation.¹² The 2017 Liberian Insolvency & Restructuring Law allows referral to ADR (mediation, in particular) for individual disputes by the bankruptcy judge, and any party may ask the judge to make such a referral.¹³ The Liberian provisions are also untested as of yet, though settlement through judge-directed pre-trial conferences has had substantial success in preventing litigation¹⁴, and suggests that mediation may have similar effects.

C. Mediation as a Tool in Pre-Insolvency Procedures in Europe

European countries have been implementing pre-insolvency procedures and complementing them with mediation over the last two decades. Luxembourg's law provides for two court-supervised reorganization proceedings which purpose is to avoid insolvency.¹⁵ In 2014, in order to increase the use of the out of court procedures, changes to the Luxembourg legislation were proposed to include appointment of a mediator as part of the procedure.¹⁶ Portugal created a pre-insolvency conciliation procedure that is carried out by the Institute for Support to Small and Medium Enterprises and Investment (IAPMEI).¹⁷ The goal of the Portuguese pre-insolvency conciliation is for the debtor to reach an agreement with some or all creditors to avoid insolvency.¹⁸ In Italy, a debtor may reach an out of court agreement with its major creditors and then have it validated by the court; the debtor may negotiate terms that would not be allowed in insolvency such as unequal treatment of

¹² Cabo Verde Insolvency and Corporate Recovery Code (No. 116/VIII/2016).

¹³ Article 8.25 of Liberian Insolvency & Restructuring Law, January 2017.

¹⁴ Liberia Commercial Court statistics from 2012 and 2013, on cases settled before trial in pre-trial conferences using mediation techniques.

¹⁵ These can be distinguished from the third reorganization procedure which is completely controlled by the court and court-appointed officers. *A guide to pre-insolvency and insolvency proceedings across Europe*, Deloitte Legal, January 2017.

¹⁶ Ogier, "Restructuring and insolvency in Luxembourg (Part 2)", *Lexology*, Global Business Media Group, July 26, 2014. Reportedly, the existing pre-insolvency procedures were rarely used so draft legislation was being considered at the time of the article's publication to include appointment of a mediator and an out of court procedural framework to help creditors reach agreement with a debtor. <http://www.lexology.com/library/detail.aspx?g=bf70f2c5-8c01-4ff9-9685-0017de8b8af5>

¹⁷ The newly introduced Business Restructuring Extrajudicial Regime (RERE) in Portugal introduces a new intermediary called "business restructuring mediator" to facilitate the negotiation between the debtor and creditors, with the main purposes to help them reach a settlement. For more information on the RERE procedure, see Ana Filipa Conceição, Cátia Marques Cebola, "Mediation as A Path to Business Restructuring - Contributions to the Portuguese Insolvency Framework", in Laura Carballo Piñeiro and Katia Fach Gómez (eds.), *Transnational Dispute Management, Special issue on Comparative and International Perspective on Mediation in Insolvency Matters*, 2017.

¹⁸ Deloitte Legal, *A guide to pre-insolvency and insolvency proceedings across Europe*, January 2017, at p. 49, at <https://www2.deloitte.com/global/en/pages/legal/articles/europe-insolvency-proceedings-guide.html>.

creditors in the same class, embracing the flexibility that mediation provides in comparison to court proceedings.¹⁹ A body was created in order to assist Italian small and medium enterprises in reaching debt restructuring agreements with creditors²⁰ that was intended to utilize mediation to facilitate negotiation, among other services, to assist companies in reaching agreements with their creditors. There are two other Italian pre-insolvency procedures that facilitate agreement between debtors and creditors without court involvement²¹, attesting to the embrace of pre-insolvency preventative procedures by Italy, in line with the trends in the EU.

D. The Example of France: Mediation Institutionalized in the Insolvency Regime

In France, pre-insolvency proceedings called Ad Hoc Mediation and Conciliation have existed in practice for many years and were formally introduced into the insolvency law since 2005. Ad hoc mediation (*mandat ad hoc*) is a confidential procedure that allows debtors to avoid publicity that may cause panic among customers and creditors. The commercial court's president appoints a special mediator at the request of a solvent debtor who faces any type of financial difficulties without actually being cash-flow insolvent. The mediator reports the condition of the company to the court and assists the company in negotiating with creditors, while the debtor retains management of the company. If an agreement is reached among the creditors, it may be formally endorsed by the court. Early in Eurotunnel's well-known financial difficulties, in 1995, the President of the Tribunal de Commerce in Paris, where the case was being administered, appointed two mediators (*mandataires ad hoc*) to facilitate restructuring negotiations. These initial negotiations resulted in a £1 billion debt equity swap, a £1.2 billion issue of equity notes, £1.2 billion issue of participating loan notes, £1.5 billion resettable bonds and a £4 billion balance of junior debt.²²

Conciliation proceedings in France are also prior to a full court insolvency proceeding, but provide stronger tools to the debtor and the conciliator than are available in a *mandat ad hoc*. A company that is in actual or anticipated financial difficulties or who has been insolvent for less than 45 days may request a conciliator to help it come to an agreement with its main creditors. The conciliator is empowered to negotiate on behalf of the debtor, who retains control of the company, and significantly, the French social and tax administrations may grant write-offs of debts through a conciliation proceeding. The debtor may also petition the court for a grace period if creditors attempt to enforce debts during the conciliation proceeding.²³ The conciliator may also help the debtor to reach agreement with creditors that is then administered through a pre-pack, under a receivership.²⁴ The French law

¹⁹ Matteo Bazzani, "Restructuring and Insolvency Law in Italy: an overview", *Practical Law*, Thomson Reuters, July 1, 2016, at [https://uk.practicallaw.thomsonreuters.com/8-501-9255?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/8-501-9255?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1).

²⁰ Giovanni Matteucci, "Mediation and Over-indebtedness in Italy", *Altalex EU*, October 2012, at <http://www.altalex.eu/content/mediation-and-over-indebtedness-italy>. The article describes the *organismi di risoluzione della crisi*, the "body of resolution of crisis", which was housed with a mediation body, and was intended to provide mediation as one of its services to businesses developing restructuring plans with creditors. Other sources have referred to a body to assist debtors in avoiding insolvency as *organismi di composizione*.

²¹ *Supra note 17* at p. 32.

²² *Eurotunnel plc & Eurotunnel S.A. and Associated Companies*, Insol International, Case Study Series – 1, August 2, 2006 and January 15, 2007. Eventually, in 2006, it sought protection of the bankruptcy court under the French *sauegarde* procedure and obtained approval of a reorganization plan. At <http://www.insol.org/TechnicalSeries/documents/INSOLInternationalTechnicalCaseStudy1.pdf>

²³ Rod Cork, Marc Santoni, "France: Restructuring and insolvency procedures", March 1, 2009, at <http://www.iflr.com/Article/2166556/France-Restructuring-and-insolvency-procedures.html>

²⁴ *Supra note 17* at p. 32.

was further refined in response to a European Commission recommendation promoting pre-insolvency procedures.²⁵

E. Individuals and Consumer Debtors: Mediators Guide, Negotiate and Educate

Assistance with negotiating debt by a neutral third party can be especially valuable for small debtors, including individuals, as part of the services of a financial literacy program.²⁶ In Bosnia, individual debtors who are facing financial difficulties have access to debt counselors, who serve to assist over-indebted individuals in negotiating debt restructuring plans with their bank lenders. The International Finance Corporation (IFC)²⁷ supported the program as part of an effort to enhance sustainable microfinance services. Many of the participants, who were facing debt payments that they could no longer make²⁸, did not fully understand the implications of their obligations, nor ways to solve debt problems with lenders—a basic lack of financial literacy. The program has succeeded beyond its initial goal of assisting 190 individuals/families; 950 debt restructurings had been completed on behalf of individuals with the assistance from the debt counselors as of January 2016.²⁹ In Armenia, the Office of Financial System Mediator, ARMACAD, has been operating since 2009 with the support of the Central Bank of Armenia. ARMACAD assists bank retail/consumer customers in resolving disputes with the banks. As in Bosnia, the program is not providing a fully neutral evaluative mediation, as ARMACAD investigate the claims and advise on their resolution; as in Bosnia, ARMACAD serves an advisory and intermediary function that has been successful in resolving many consumer disputes that are brought to its offices.³⁰ While court processes may prove intimidating and out-of-reach for individual or microenterprise debtors, financial intermediation assistance from dedicated, trained, informed professionals geared toward their needs, whether for microfinance or consumer debt issues, has promise and demonstrates the value of third party assistance in debt resolution to prevent insolvency.

F. Asian and African Countries Also Embracing Mediation in the Context of Pre-Insolvency Procedures

Asian economies have long recognized the value of pre-insolvency negotiations with creditors and supporting those negotiations with mediation. Japan recognizes formal mediation as a tool for such pre-insolvency proceedings. In 2007, Japan established an out-

²⁵ Didier Bruere-Dawson, “The 2014 Reform of the French Bankruptcy and Insolvency Proceedings”, *CorporateLiveWire*, February 24, 2015, at <http://www.corporativelivewire.com/top-story.html?id=the-2014-reform-of-the-french-bankruptcy-insolvency-proceedings>

²⁶ While the professionals that assist the individuals in the programs described are not trained mediators, the programs serve to intermediate between small debtors and their bank lenders. Even though the process is not as neutral as a mediation between two parties choosing an independent mediator, the professionals involved are trained to work with both parties and solve disputes without court action; the imbalance of power and knowledge between a consumer borrower and bank, and the need for guidance to the consumer may render directed assistance more suitable for such disputes than the full evaluative mediation process.

²⁷ The International Finance Corporation, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector in developing countries.

²⁸ In many of the case, the inability to service their outstanding debt would have led to the insolvency of these debtors.

²⁹ IFC News Release, “Financial Counseling Helps Bosnian Residents Resolve Debt”, August 2016, at http://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/financial-counseling-helps-bosnian-residents-resolve-debt.

³⁰ Observations and information collected during World Bank Group in-country interviews in Armenia. ARMACAD’s webpage is at <https://armacad.info/office-of-financial-system-mediator-armenia>.

of-court workout scheme, called Turnaround ADR, to allow rescue of companies in financial distress outside of court. Only financial creditors are involved, protecting the trade creditors and debtor's relationship with them. The scheme is guided by a private sector institution, the Japan Association of Turnaround Professionals ("JATP"), which is both certified under the 2004 Act on Promotion of Use of Alternative Dispute Resolution under the Ministry of Justice of Japan, and qualified as a certified dispute resolution business operator under the Industrial Competitiveness Enhancement Act under the Ministry of Economy, Trade, and Industry, to manage the Turnaround ADR procedure.³¹ The process itself is conducted by JATP mediators skilled in business turnaround and in mediation techniques.³² Reportedly, the out of court workouts are increasingly preferred over the procedures provided in the Japanese insolvency law. Between 2007 and 2016, 55 turnaround cases were filed under the Japanese Turnaround ADR scheme.³³ In addition to the out-of-court workout scheme led by the private sector in Japan, certain quasi-governmental institutions having "revitalization" as their mission, also provide assistance to Japanese companies in financial distress, serving as mediators between the debtor and its financial creditors as well assisting with inter-creditor adjustment.³⁴

Thailand has set up a court-annexed mediation program, the Thai Mediation Center along with the Bankruptcy Court established in 1999 in the wake of the Asian Financial Crisis.³⁵ The Thai Mediation Center played an important role supporting the Corporate Debt Restructuring and Advisory Committee (CDRAC) in assisting companies in restructuring.³⁶ Mediation of disputes appears to have been an important service that contributed to successful restructurings in Thailand.³⁷ It is noteworthy that in Thai out of court restructurings, in contrast to court reorganization, there must be unanimous agreement of financial creditors but trade creditors enjoy significant protection against compromise of claims, which preserves debtor's relationships to them and keeps the business running.³⁸ Among other Asian countries that have successfully incorporated mediation (mediation is used and restructurings are happening) into their corporate debt restructuring schemes are Korea³⁹ and Indonesia⁴⁰.

³¹ See Shin-Ichiro Abe, "The Role of Mediation in Japanese Insolvency Practice", Laura Carballo Piñeiro and Katia Fach Gómez (eds.), *Transnational Dispute Management, Special issue on Comparative and International Perspective on Mediation in Insolvency Matters*, 2017.

³² http://www.meti.go.jp/policy/jigyousaisei/ADR%20HP_E-virsion_100126.pdf and <http://www.iflr.com/Article/3549971/2016-Insolvency-and-Corporate-Reorganisation-Report-Japan.html>

³³ Shin-Ichiro Abe, "Japan", *The Strategic View—Corporate Restructuring 2016*, at <http://www.strategicview.co.uk/strategic-view/corporate-restructuring/the-strategic-view-corporate-restructuring-2016/japan>

³⁴ An example of such quasi-governmental institution is the Regional Economy Vitalization Corporation of Japan "REVIC". For more information on REVIC and the assistance it provides to distressed debtors, see Shin-Ichiro Abe, *supra note 30* at p. 6.

³⁵ Supreedee Nimitkul, "Thailand develops court-supervised restructuring", *Restructuring e-newsletter – Global Insight*, 1 March 2012, published by DLA Piper. At <https://www.dlapiper.com/en/us/insights/publications/2012/03/thailand-develops-courtsupervised-restructuring/>

³⁶ Sorawit Limparangsri and Montri Sillapamahabundit, *Mediation Practice: Thailand's Experience*, date after 2011 but not provided, at <https://www.aseanlawassociation.org/11GAdocs/workshop5-thai.pdf>

³⁷ *Informal Workouts, Restructuring and the Future of Asian Insolvency Reform Proceedings from the Second Forum for Asian Insolvency Reform - December 2002* beginning at page 218. At <https://www.oecd.org/daf/ca/corporategovernanceprinciples/16211282.pdf>.

³⁸ *Supra note 30*.

³⁹ The Mediation Center in Korea, specifically for creditor financial institution disputes, mediates disputes during out of court restructuring proceedings under the Korean Corporate Restructuring Promotion Act. Shinjiro Takagi and Shinichiro Abe, "Using ADR to Manage and Prevent Insolvency in Korea and Japan",

The wave of introducing mediation into insolvency systems has also reached Africa, but are yet to be tested. In Africa, Cabo Verde introduced a pre-insolvency procedure when it passed its first insolvency law in 2016, which relies on mediators to drive the process.⁴¹ In Francophone Africa, the OHADA Uniform Act on Bankruptcy Proceedings contains a provision providing for mediation to prevent insolvency.⁴² OHADA, the Organization for Harmonization of Business Laws in Africa, counts 16 Francophone countries as its members. All OHADA countries are party to the 2015 version of the Uniform Act on Bankruptcy Proceedings that contains the provision, enabling mediation to be implemented in all of those states. It is safe to say that the use of mediation to assist parties in preventing insolvency and promoting reorganization is increasing, and spreading worldwide.

III. Using Mediation During an Insolvency Proceeding

A. Ad hoc as needed during an insolvency proceeding

Mediation can be useful to help resolve individual disputes that otherwise would be litigated and lead to delay, or even jeopardize resolution of the bankruptcy. As the American Bankruptcy Institute’s webpage on bankruptcy mediation states:

“The use of mediation generally occurs in two ways. First, any single claim or preference can be mediated on an ad hoc basis—much like any other legal dispute. The parties merely need to agree to try to resolve the dispute in this manner and obtain the court's approval where necessary. This is not difficult to do. Bankruptcy courts around the country welcome the voluntary use of alternative dispute resolution to resolve cases outside of the courtroom. Judges are delighted when the parties find ways to settle without tying up their courtrooms in trial.”⁴³

Consequences of unresolved disputes within an insolvency proceeding can be quite serious and can undermine a potentially successful restructuring. It can also cause delay and expense such that the creditors’ recovery is reduced or eliminated. Mediation has rescued insolvency proceedings that may otherwise have failed or returned much less to creditors for several well-known large insolvency cases.

In the U.S., especially, and in several other countries, mediation is used to address disputes that arise within bankruptcy cases. As described below, several U.S. bankruptcy courts mandate mediation for issues such as preference claims, adversary proceedings (disputes heard by the bankruptcy judge as part of the case), and claim objections.⁴⁴ In other

Powerpoint presentation at International Insolvency Institute 11th Annual Conference, June 13-14, 2011, New York.

https://www.iiiiglobal.org/sites/default/files/media/15Using_ADR_to_Manage_and_Prevent_Insolvency_Shinjir_o_Takagi.PDF

⁴⁰ *Informal Workouts, Restructuring and the Future of Asian Insolvency Reform Proceedings from the Second Forum for Asian Insolvency Reform - December 2002* beginning at page 218. At <https://www.oecd.org/daf/ca/corporategovernanceprinciples/16211282.pdf>.

⁴¹ Insolvency and Corporate Recovery Code, Law No. 116/VIII/2016, effective March 22, 2016, beginning Article 83.

⁴² OHADA Uniform Act on Bankruptcy Proceedings, Unofficial Translation, 10th September 2015, Article 1-2.

⁴³ “FAQ on Bankruptcy Mediation”, *ABI Journal*, American Bankruptcy Institute, <http://www.abi.org/abi-journal/faq-on-bankruptcy-mediation>.

⁴⁴ A recent notable case where mediation was mandated by the bankruptcy court was in the bankruptcy proceeding of the City of Detroit, filed under Chapter 9 of the U.S. Bankruptcy Code, which governs municipal

common law countries, such as the U.K. and Canada, mediation is also commonly used during insolvency, ad hoc for disputes that may hinder the progress of the proceeding. In Europe, mediation in this context has been less common but has a presence that may be growing. For example, in the Netherlands, the District Court in Amsterdam started a pilot project for mediation in bankruptcy liquidation cases. Mediation processes are supervised by experienced mediators, and the Dutch judge supervises the settlement reached, although its success rate is yet to be assessed.⁴⁵

1. Examples of Mediation of Contested Issues within an Insolvency Proceeding

Lehman Brothers is a well-known example of the successful use of mediation once the insolvency proceeding is already underway. When Lehman Brothers filed for bankruptcy in 2008, there were 1.2 million derivative transactions with 6500 counterparties. Rather than prosecute hundreds of cases across many different countries, Lehman obtained permission to mediate them. According to a February 2013 report filed with the bankruptcy court, Lehman was able to successfully reach settlement in 93 of 98 mediated cases. This resulted in \$1.39 billion for the bankruptcy estate, for distribution to creditors.⁴⁶ MF Global is a similar example. In both of these insolvency proceedings, the use of mediation resulted in large gains to creditors by bringing in settlement money at a lower cost than full court proceedings. After the 2011 filing, affiliates in the U.S. and U.K. cross-claimed against each other, threatening protracted litigation. In 2012 the bankruptcy judge encouraged mediation, which was successful in resolving disputes and allowed MF Global's creditors to receive a total of \$1 billion in distributions.⁴⁷

In the famed General Motors bankruptcy case, mediation resolved a claim brought by creditors after the original pre-packaged plan had been implemented. The post-bankruptcy claim in the GM case threatened to undo the whole rescue of the iconic American company. While the original plan was approved in 2009,⁴⁸ hedge fund creditors continued to litigate a \$3 billion claim, asking to unwind a large transaction that occurred at the time of the bankruptcy filing. The hedge funds' claim was referred to mediation, where the plaintiffs agreed to cut their claims in half, thus allowing increased recovery for other creditors, and accept \$50 million in settlement of the claim, which allowed the existing arrangements to continue and thus preserved the rescue.⁴⁹

Among the successes are failures, as demonstrated by Nortel's bankruptcy. After Nortel's assets were sold for \$7.5 billion, the affiliates in the U.S., Canada, UK and France could not agree on their division. Many rounds of mediations failed⁵⁰. Mediation was followed by litigation and appeals until in 2017 the case was finally settled. The total in fees

bankruptcies but resembles Chapter 11 in its structure, including the use of court-mandated mediation in the situation described above. For a review of the court decision with respect to the importance of the use of a mediation process, see Allan L. Gropper, "The Mediation of Bankruptcy Disputes in the United States", Laura Carballo Piñeiro and Katia Fach Gómez (eds.), *Transnational Dispute Management, Special issue on Comparative and International Perspective on Mediation in Insolvency Matters*, 2017.

⁴⁵ *Supra* note 1.

⁴⁶ Andrew J. Olejnik and Oliver P. Andre, "ADR in Bankruptcy: Expanding Opportunities", *BNA's Bankruptcy Reporter*, Bloomberg Bureau of National Affairs, 2013.

⁴⁷ Kayjal Dasan and Samuel Seow, "Seminar Review: Mediation in International Insolvency", *International Arbitration Asia*, (20 September 2015).

⁴⁸ <http://ih.advn.com/p.php?pid=nmona&article=59688533>

⁴⁹ *Ibid.*

⁵⁰ *Supra* note 43.

and costs was reportedly \$1.9 billion.⁵¹ Despite failures, which are inevitable in any alternative, mediation as an insolvency resolution tool is growing in stature and use, as evidenced by its spread, and the number of countries incorporating it into law as an option in insolvency cases.

2. In Emerging Markets, Mediation is Increasingly Incorporated During Recent Insolvency Reforms

Several emerging market countries have incorporated the potential for ad hoc mediation of matters that arise within insolvency proceedings during recent reform of their insolvency regimes. Serbia is one example among many. In Serbia, creditors or the bankruptcy administrator may propose resolution of creditors' claims through out-of-court mediation. The mediation duration is limited to 30 days from the investigative hearing when all claims are compiled, unless it is extended. According to a 2012 report, uptake of the mediation option in Serbia has not been high, attributed to lack of familiarity with the mediation process among attorneys and litigants. The newly-enacted 2017 Liberian insolvency law allows for referral of disputes that arise during the insolvency case to alternative dispute resolution, which in Liberia, is the court-annexed mediation program of the Monrovia Commercial Court. However, since the law is new and untested, results of this program cannot be assessed. Nevertheless, the inclusion of mediation referral in these laws reflects the growing consensus that making mediation available during an insolvency proceeding is considered among best practices.

B. Case management through mediation of categories of insolvency actions

Categories of claims or actions in an insolvency case can be assigned to be mediated as a case management tool to expedite proceedings. In the U.S., the Delaware bankruptcy court mandated mediation for preference actions beginning in 2004. It added mandatory mediation for adversary actions and avoidance actions for amounts greater than USD 75,000 in its 2013 court rules.⁵² The expansion by the court of mandatory mediation to other actions may be read as a reaction to the success of the first introduction of mandatory mediation into the insolvency process.⁵³ In New Jersey also the bankruptcy courts have rules setting forth a presumptive referral of all adversary proceedings or contested matters to mediation.⁵⁴ The Central District of California Bankruptcy Court also instituted a mediation program for disputes, in recognition of the need for lower-cost and speedier resolution, without litigation.⁵⁵ The ubiquity of the programs, and the tendency to expand them, suggest the value of mitigation for case management, for the litigants and court.

Complex cross-border insolvency proceedings can particularly benefit from mediation of actions that are numerous and cross jurisdictions. It should be noted that for cross-border cases especially, as in the Lehman Brothers case, streamlining the resolution of claims or similar actions through cross-border mediation can save the time and expense of coordinating the rules and procedures in various jurisdictions. As noted by a commentator:

⁵¹ Reuters, "Nortel Cleared to End Bankruptcy", *Fortune*, January 24, 2017. At <http://fortune.com/2017/01/24/nortel-end-bankruptcy/>

⁵² <http://www.rlf.com/Practices/4977>

⁵³ Donald L. Swanson, "Success of Mandatory Mediation Leads to Expansion of Its Role", January 5, 2017 at <https://mediatbankry.com/2017/01/05/success-of-mandatory-mediation-leads-to-expansion-of-its-role/>

⁵⁴ *Supra note 3.*

⁵⁵ <http://www.cacb.uscourts.gov/mediation-program>

“The field of international insolvency is ripe for intervention via mediation. The speed and flexibility of mediation makes it an ideal process for multinational companies who are seeking to avoid the costly and time consuming quagmire of transnational litigation. Particularly in the current global economic climate, it anticipated that the prominence of international mediation in cross-border insolvency cases is set to increase. It is possible that more alternate dispute resolution institutions may offer specialized rules and panels to administer the mediation of complex cross-border insolvency disputes.”⁵⁶

In recognition of the increasing value and frequency of use of mediation in transnational cases, INSOL International, an association of professionals involved in insolvency worldwide, established an Insolvency Mediation panel around 2016. The panel of mediators is available to assist during transnational insolvency restructurings, particularly to assist in resolving disputes.⁵⁷

IV. Conclusions

Mediation is becoming an important part of insolvency laws worldwide. It is clear from the number of countries incorporating mediation into their insolvency and out of court workout regimes, and the number of high profile insolvency cases that succeed through either a pre-insolvency negotiation assisted by mediation or mediation of key disputes within the case. Using mediation to enhance the success of insolvency processes has become a best practice. Unscientific, untested observations that may be drawn from the examples presented above include:

- Mediation is not adopted automatically through availability alone. “If you build it. . . they may NOT come.” Lack of awareness and lack of experience with mediation inhibits its use; both are likely to benefit through the intervention of policymakers through public education and mechanisms such as mandatory or judge-referred mediation to create a credible, functioning system.
- The type of mediation that successfully assists in the context of insolvency proceedings can be considered more like facilitative mediation or conciliation, than purely evaluative mediation. Most of the schemes described, and in most of the case examples, mediators were experts in turnaround or insolvency or related aspects, and actively assist and advise parties on what to do, though agreement is voluntary.
- State participation in promoting mediation seems to be a significant factor in the successful use of mediation in insolvency. In the U.S., this includes court-mandated mediation of specific types of disputes. In European, Asian and non-common law countries, state-designated professionals or entities such as the court-assigned mandataires ad hoc and conciliators in France, or mediation entities specially dedicated to assisting with corporate debt restructurings as in Asian countries provide further examples.
- Pre-insolvency procedures, and out of court workouts, to prevent insolvency and liquidation, are spreading across the globe, and mediation is part of the tools associated with them. Mediation was part of the systems that were first created after the Asian Financial Crisis in Thailand, Indonesia and Korea, the role of mediation has been enhanced for the most recent Japanese turnaround scheme, and is incorporated

⁵⁶ *Supra note 43.*

⁵⁷ INSOL International website, “Mediation” page, <https://www.insol.org/page/604/mediation-panel>.

into several European pre-insolvency procedures. Emerging market countries creating their first insolvency laws in recent years, such as in Africa, have also included mediation and mediators as part of their pre-insolvency procedures.

- For transnational disputes, such as Eurotunnel and Lehman Brothers, mediation of disputes can be indispensable to success, allowing the parties to avoid the vast expense and delays of litigation in multiple jurisdictions.

These conclusions are merely observational, and not scientific or subject to empirical testing, based on the information presented. While it is tempting to say “further studies are needed”, designing truly rigorous studies that quantify the success of mediation, or identify elements of its success across countries, may not be possible. The extent of the use of mediation and its success will depend largely on fitting the mediation approach to the needs of each restructuring and insolvency system, and in large cases, to each particular case.