

Recent Use of Mediation for Resolution and Effective Management of Large Case Insolvencies

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Introduction

The use of claim resolution facilities, which use structured negotiation and mediation to resolve large numbers of disputed matters in substantial insolvency cases in the US, was developed in the 1990s in the context of significant Chapter 11 cases. It has become a standard feature in cases involving hundreds or thousands of disputed creditor claims and recovery actions. The use of mediation to reach consensual plans of reorganization, while not yet standard protocol in cases, has become common and is no longer controversial. This article explores the history and recent uses of mediation in substantial insolvency cases in the US and suggests methods of introducing mediation in cases in Europe as well.

Managing litigation

A claim resolution facility is a custom-designed alternative dispute resolution program using structured negotiation, mediation and, sometimes, arbitration to resolve disputed claims in insolvency cases. The program, the terms and implementation of which must be approved by the bankruptcy court after notice and hearing, is typically drafted, proposed and administered by attorneys representing the Chapter 11 debtor business or its representative.

The facility enhances prospects of reaching a negotiated settlement by promoting the exchange of necessary information and providing a procedure for the exchange of a settlement offer and a counteroffer. If the structured negotiation provisions do not yield a

quick settlement, the facility will provide for mediation to commence with mediators previously approved by the court based on recommendations usually made by the debtor or its representative. If mediation is not successful, some facilities may then provide for arbitration.

Since these procedures are not governed by formal rules of evidence and procedure, there can be a significant saving of time and cost for all parties. The success of the early facilities has made them a mainstay in today's practice. In one of the first uses of a facility in the 1990s, the procedure implemented in the Greyhound Bus Chapter 11 case involved more than 3,000 claimants.² The procedure was subsequently used successfully in many other cases involving substantial numbers of disputed claims.³

Experience demonstrates that voluntary settlements occur in the great majority of matters where facilities are used, with the majority of the settlements occurring even prior to the mediation stage. A recent example is in the *Lehman Brothers* liquidating Chapter 11 cases in the Southern District of New York, where structured negotiation and mediation was used to manage and resolve hundreds of disputes arising from early termination of derivative contracts due to the bankruptcy filings.⁴ A June 2015 status report states that over USD 2.9 billion was collected by the Lehman Estate in 410 ADR matters resolved with 527 counterparties. Of the 235 disputes that went through mediation and were concluded as of the time of the report, 219 were settled and only 16 failed to reach settlement.⁵ A similar facility has been used to manage and seek resolution of numerous clawback actions in the *Madoff* SIPA liquidation case, although public reporting of the results has not been provided.⁶

Notes

- 1 Mr. Esher would like to thank his colleagues at CBIInsolvency, LLC, Daniel Glosband, Esq., retired partner of Goodwin Procter, and Hon. Leif M. Clark (ret.), for their contributions to this article.
- 2 *Eagle Bus Mfg., Inc. v Rogers*, 62 F.3d 730, 734 n. 6, 27 BCD 982, 983-84 (5th Cir. 1995).
- 3 See *In re Kmart Corporation, et. al*, Case No. 02-B02474 (SPS) (Bankr. D. Del. 2002); *In re Harnischfeger Industries, Inc.*, Case No. 99-2171 (PJW) (Bankr. D. Del. 2000); *In re Venture Stores, Inc.*, Case No. 98-101-RRM (Bankr. D. Del. 1998); *In re Rich's Department Stores, Inc.*, Case No. 96-11793-JNF (Bankr. D. Mass. 1998).
- 4 *In re Lehman Bros. Holdings Inc.*, No. 08-13555 (SCC) (Bankr. S.D.N.Y. 2008). The author is one of the court-appointed mediators in this case.
- 5 *Ibid.*, Letter to Honorable Judge Shelley C. Chapman Regarding Sixty-Seventh ADR Status Report (9 June 2015, ECF No. 49939).
- 6 Order (1) Establishing Litigation Case Management Procedures for Avoidance Actions and (2) Amending the February 16, 2010, Protective Order, *In re Bernard L. Madoff, SIPC v. Bernard L. Madoff Investment Securities LLC*, Adv. Pro. No. 08-01789 (SMB), Dkt. No. 3141, 10 November 2010 (Bankr. S.D.N.Y. 2008).

Why mediation?

Why do parties choose mediation over court proceedings and why has it become the preferred means of dispute resolution? To answer these questions, it is necessary to look at the hallmarks of the adjudicative process in court proceedings and in arbitration, the more traditional out-of-court process.

Arbitration has similar attributes to litigation in a court process. One or more arbitrators replace the judge and/or jury. While formal rules of evidence are not necessarily applicable in arbitration, the process is similar to court litigation in which each side presents evidence and testimony. Once the issues are submitted to the arbitrator, the parties no longer control the outcome and will be bound by the decision of the arbitrator. Liability and damages are as prescribed by applicable law, at least to the extent it is understood and applied by the arbitrator. Little consideration is given to circumstances or other interests of the client parties that are not germane to the governing principles of law and damages.

The result of an arbitration or a court adjudication is a directed resolution, not a voluntary compromise. The time, costs and fees incurred in the court process or arbitration are invested in obtaining the court or arbitrator's decision, despite the fact that the majority of cases ultimately settle before trial. By contrast, the time, costs and fees of a mediation are expended directly on obtaining a consensual settlement.

Mediation is not an adjudicative process, it is a negotiative one. In mediation, an impartial person serves as the mediator to facilitate the negotiation process among the parties, and is given no authority to decide the outcome. The mediator, unless court-selected, is chosen by agreement among the parties, and will be someone with suitable training and experience in serving as a mediator as well as experience and knowledge in the relevant subject matter. Through a series of both joint and separate meetings (called caucuses) with decision-maker representatives for each party and their counsel, the mediator assists the parties in negotiating a resolution. The meetings are convened pursuant to a written and signed mediation agreement among the parties and the mediator. The agreement is usually quite simple and prepared by the mediator to memorialize the parties' agreement to mediate and set forth basic logistics, including the agreed compensation terms for the mediator. While it is common in two-party disputes for the mediation costs to be shared by the parties, it is more common in claim resolution facilities that the debtor or its estate foot the costs as an administrative expense of the restructuring. Most

importantly, the agreement will include comprehensive provisions regarding confidentiality of the meetings. Often, the agreement will simply incorporate the presiding court's local rule governing mediations in its cases, which rules commonly include confidentiality provisions. Confidentiality allows the parties to be more candid with the mediator and each other without fear that statements made during the mediation could subsequently be used against a party in court should the mediation not be successful.

These hallmarks of the mediation process allow the parties in the case to control the outcome. The mediator serves as a buffer against the contentious positioning and argument that often derails direct negotiation, greatly increasing the prospects for resolution. However, no bargaining leverage is lost nor are concessions made save those a party chooses to make, based on that party's perception that a given concession might contribute toward settlement.

Mediation eliminates the risk of unfavourable rulings resulting from the process. It can save substantial money and time. Most importantly, mediation can inspire creative and realistic solutions that are attuned to each party's respective interests. Due to its flexibility and efficiency, mediation has become the preferred ADR process to resolve claims in insolvency cases in the US and it has been used increasingly to reach consensual plans to resolve complex, multi-party restructurings.

Complex consensual restructurings

Recent improvements in insolvency procedures across Europe, most notably the French Sauvegarde, the Dutch Akkoord, the German Protective Shield, the Spanish Pre-concorso, and the Romanian Preventive Concordat demonstrate the desirability and importance of consensual restructurings. In the UK, schemes of arrangement are based on obtaining the consent of at least 75% of the impaired creditor classes, similar to the majority rules for creditor consents in Chapter 11 cases. In addition, the European Parliament has promulgated rules and recommendations for the broader use of mediation in the cross-border context within the Union.⁷ Three notable complex multi-party restructuring cases in the US demonstrate just how successful mediation can be in breaking through negotiation impasses to reach a consensual resolution.

The municipal bankruptcy case of the city of Detroit, Michigan⁸ reflects a recent and remarkable use of mediation to achieve confirmation of a consensual plan. Mediation was critical to the successful resolution of this landmark case, completed consensually in

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⁷ See footnotes 11, 12 and 13 below.

⁸ *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. 2013).

an unprecedented 16 months. Presiding Bankruptcy Judge Steven Rhodes appointed Federal District Judge Gerald Rosen as primary mediator in the case, and he appointed several other mediators to achieve consensual resolutions of major creditor-employee-retiree-city disputes necessary for confirmation of the plan. The mediators had to consult with each other and coordinate their respective sessions since many resolutions were dependent on other resolutions. In an interview about the case, Judge Rhodes stated that ‘The way to resolve them [bankruptcy disputes] is not through litigation, it’s through mediation and negotiation.’

Mediation has been used to reach consensually confirmed plans in Residential Capital LLC and Cengage Learning, Inc. Chapter 11 cases in (respectively) the Southern and Eastern Districts of New York. In these cases and similar large, multi-party reorganizations, the estate paid the costs of the mediation, including compensation of the mediator.

In the Cengage case,⁹ with nearly USD 6 billion in debt, five extensive, all-day mediation sessions and numerous phone calls with the mediator were held between October 2013 and January 2014 in which the debtors and all of their key stakeholders engaged. Before each mediation session, the parties negotiated an issues list and submitted mediation statements to the mediator, outlining their key arguments regarding each issue. On January 23, 2014, the mediation successfully concluded in a global settlement that resolved all outstanding issues between the parties. The five-month process avoided the potential of years of adversarial proceedings in Chapter 11.

In the case of multi-billion dollar mortgage originator Rescap and its 50 subsidiaries,¹⁰ it took ten months to get to a consensual plan, but a significant amount of time was spent with little progress due to hedge fund concerns of liability for trading on ‘MNPI’ – material non-public information. After mediation succeeded in the negotiation and court approval of a form of comfort order (a so-called *Vitro* order) to protect against such claims, the plan was successfully negotiated through mediation and confirmed.

Particularly of note in cases involving hedge funds is the ‘double whammy’ of litigation costs – the costs

expended by hedge funds in an insolvency case are subtracted from the fund’s rate of return, making it more difficult to settle at the rate the fund perceives to be appropriate, while the costs expended by the debtor or estate, which are administrative in priority, decrease the value distributable to the fund under a plan. Applying these costs directly to achieve consensus through mediation is a more efficient and productive process.

Concluding thoughts on using mediation in European cases

In a recent round of meetings in the UK, we heard that restructuring cases have become more contentious. We also heard that, consequently, administrative costs and expenses have become more burdensome for all parties. In exploring how mediation might help in EU cases, several ideas – and several issues – surfaced.

Our general impression is that mediation is being used at least to a limited extent. As parties and counsel are getting more familiar with it, they are more likely to agree to participate. An EU directive¹¹ on the use of mediation for disputes in cases and particularly cross-border matters has been the subject of an extensive study conducted under the Directorate-General for Internal Policies of the European Parliament,¹² and is likely to be revised to further promote the use of mediation more effectively.¹³

However, while the work of the Committee on Legal Affairs clearly showed that mediation was effective in resolving disputes and saving costs, getting parties to use it in the EU may be problematic without some form of court or regulatory compulsion. The bankruptcy courts in the US have extensive jurisdiction over creditor claims and a debtor’s causes of action, making it easier to implement a comprehensive mediation protocol in a case. As more parties and counsel have participated in the process over the years, its use has become less dependent on court persuasion. With the increasingly global scope of business enterprises, it is more likely that parties and/or their counsel will be familiar with the utility and relative safety of mediation and be prepared to participate in mediation of complex EU restructurings.

Notes

- 9 *In re Cengage Learning Centers, Inc.*, No. 13-44106 (SSG) (Bankr. E.D.N.Y.). The author wishes to thank the law firms of Kirkland & Ellis LLP and Morrison & Foerster LLP for information pertaining to these cases.
- 10 *In re Residential Capital, LLC*, No. 12-12020 (MG) (Bankr. S.D.N.Y.).
- 11 Directive 2008/52/EC of the European parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters, OJ L 136, 24.5.2008, available at <<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32008L0052&from=EN>>, 27 July 2015.
- 12 *Rebooting the Mediation Directive: Assessing the Limited Impact of Its Implementation and Proposing Measures to Increase the Number of Mediations in the EU*. The Study is available at <www.europarl.europa.eu/study>, Doc. No. 493.042, 27 July 2015.
- 13 See European Parliament Resolution of 13 September 2011 on the Implementation of the Directive on Mediation in the Member States, its Impact on Mediation and its Take-up by the Courts (2011/2026(INI)), Official Journal of the European Union CE 51/17 (2013/C 51 E/03, 22.2.2013), available at <<http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52011IP0361&qid=1438028775450&from=EN>>, 27 July 2015.

The global nature of business enterprises today also provides another positive reason to pursue mediation as a solution to thorny disputes, especially those without a clearly indicated forum in which to obtain a judicial solution. Indeed, disputes that arise in cross-border court processes such as in cases under the Model Law on Cross-Border Insolvency (enacted in the U.S. as Chapter 15 of the U.S. Bankruptcy Code) are increasingly likely to be mediated, by order of the court or courts managing the dispute. Examples include disputes over recognition, COMI, discovery, avoidance actions applying the law of the foreign proceeding and recovery on other causes of action. The use of a companion Chapter 15 proceeding to an EU-based main proceeding to get recalcitrant parties into mediation and increase the prospects for a consensual resolution could be considered.

Restructurings within the European community can be especially challenging when they cross borders – even when the borders are within the EU. Mediation as an alternative to what can be a time-consuming and expensive process seems to be worthy of serious consideration.