

10 reasons why insolvency practitioners should consider ADR

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Alternative Dispute Resolution (**ADR**) provides insolvency practitioners with a vast range of options when it comes to enforcing claims available to liquidators, administrators, receivers or trustees. Those options can extend from simple negotiation (assisted or not) to mediation, conciliation and arbitration.

Mediation in particular has become a very valuable tool for resolving disputes of all kinds, including those in the insolvency sphere. While the prospect of attending a mediation might once have been considered by courts and litigants to be a sign of weakness or vulnerability, this is no longer the case. Mediation has become a standard part of most litigation processes, and in Australia, it has been reported that approximately 60% of all disputes referred to mediation in the Australian superior court system settle.¹

As an insolvency practitioner, you may ask yourself “*Why would I have to mediate? Why not just go straight to court?*”

There are numerous reasons why claimants and defendants alike might prefer ADR, and some insolvency practitioners may even find themselves being drawn into the process whether they like it or not.

Here are 10 good reasons why you, as an insolvency practitioner, should consider and use ADR.²

Why use ADR?

1. To comply with your fiduciary responsibilities

In Australia, liquidators, administrators and receivers all become “*officers*” of the companies to which they are appointed. This means they become subject to the same duties that are imposed upon company directors. Insolvency practitioners also have further duties to be fair and to act without bias in assessing the competing interests of stakeholders,³ and to act with integrity, objectivity and impartiality.⁴

Obtaining an outcome during an ADR process that is satisfactory to all stakeholders (including the creditors) should involve the application of all these duties. If that outcome can be achieved at an early stage of a dispute, without the delay and expense usually associated with full scale litigation, then the insolvency practitioner can hardly be criticised (and in fact, may be applauded for taking a constructive, conciliatory approach).

¹ National Alternative Dispute Resolution Advisory Council *ADR Statistics 2003*. As mediations often result in confidential settlements, current statistics are hard to come by. However, given the increase in popularity of mediations since 2003, there is no reason to believe this success rate has declined.

² While some of these 10 reasons are linked to aspects of the Australian dispute resolution framework in particular, others are linked to broader concepts that are likely to be applicable in any jurisdiction.

³ ARITA (Australian Restructuring Insolvency & Turnaround Association) Code of Professional Practice for Insolvency Practitioners (**the Code**), paragraph 2.5.

⁴ The Code, paragraphs 5.1, 5.2 and 5.3.

2. Because the courts can say so

In Australia, the *Civil Dispute Resolution Act 2011* (Cth) requires any applicant in a Commonwealth court (such as the Federal Court or Federal Magistrates Court) to file a “Genuine Steps Statement” at the time of filing any application.⁵ The Genuine Steps Statement must specify:

- a) the steps that have been taken to try to resolve the issues in dispute between the applicant and the respondent in the proceedings; or
- b) the reasons why no such steps were taken, which may relate to, but are not limited to, the following:
 - i) the urgency of the proceedings;
 - ii) whether, and the extent to which, the safety or security of any person or property would have been compromised by taking such steps.

The “genuine steps” include:

- notifying the other party of the issues in dispute and offering to discuss them;
- providing relevant information or documents to the other party;
- considering and/or participating in ADR; and
- negotiation.

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How might this issue come into play in the insolvency sphere? Examples include Federal Court proceedings that involve attempted recoveries of unfair preference payments, or an insolvent trading claim against a director. In both cases, a Genuine Steps Statement would need to be filed at the time of the commencement of the proceedings.

While a failure to file a Genuine Steps Statement does not invalidate the proceedings, adverse costs orders can be made against you, or even your lawyers.

A Genuine Steps Statement that points to ADR having been undertaken can be useful, and it is worth noting that engaging in *some* form of ADR does not necessarily mean that you have to launch straight into a mediation.

It should also be borne in mind that both the Australian Federal Court and the State Courts in most Australian jurisdictions also have power to order parties to participate in a mediation anyway,⁶ even if there is no formal requirement for a Genuine Steps Statement to be filed (which is the case in the Supreme Courts of NSW, Victoria and Queensland).

Australia is not the only country with mandatory mediation schemes. Similar schemes apply in a number of other jurisdictions including New Zealand, the United States, China, Italy, Canada and Scandinavia.

3. It’s more time and cost-efficient

Mediation is usually a far more economical means of dispute resolution than either litigation or arbitration. A mediation can be undertaken at any stage of any proceedings, or even before proceedings are commenced (ie as a “genuine step” before issuing the proceedings). While lawyers will often complain that “*we don’t know the case we are answering, since we haven’t seen their evidence!*” clients may not harbour the same concerns, and are usually prepared to move towards a mediation much faster than their advisors. It is true that a mediation conducted ‘too early’ might not succeed, but it is a good basis to engage in further negotiations as more material may come to light.

⁵ Section 6.

⁶ For example, see section 26 of *The Civil Procedure Act 2005* (NSW).

4. Because parties like the Australian Tax Office will go that way

Agencies of the Commonwealth Government in Australia have an obligation to act as a “*model litigant*” in conducting any litigation. This direction includes:

“endeavouring to avoid, prevent and limit the scope of legal proceedings wherever possible, including by giving consideration in all cases to alternative dispute resolution before initiating legal proceedings and by participating in alternative dispute resolution processes where appropriate.”⁷

In particular, the Australian Taxation Office (**ATO**) is expressly bound by these provisions which have been incorporated into its *Practice Statement Law Administration PS LA 2009/9*.

So, litigation by insolvency practitioners against the ATO will often lead towards a mediation, or some other form of ADR, before a final hearing.

5. In litigation, there is only one winner

Despite the optimism that all litigants will feel at the start of litigation, at least half of them will go on to lose once they go to trial. This is a confronting reality that you should always bear in mind, no matter how strong you may think your arguments are.

If you conduct litigation against a creditor, a director, a bankrupt or any other party, a judgment can only go one way. Further, it may go the other way on appeal, along with the costs, expenses and delays. You also may not have sufficient funding to take your claim ‘all the way’ through the courts.

The benefit of ADR, and particularly mediation, is that you have an opportunity to assess your opponent’s case, including its strengths and weaknesses, at an early stage. In doing so, you can calculate the risks versus the benefits of continuing your litigation, as opposed to possibly just settling for ‘something less’.

A settlement at mediation is usually a case of each party discounting their expectations to account for the risk of the worst case outcome (ie, losing the case with adverse costs orders). It allows the dispute to be resolved on terms that each party is prepared to live with, whilst at the same time, hopefully, benefiting those parties as well.

6. It is confidential

Other than in limited circumstances,⁸ all information obtained, discussions, offers, counter-offers, negotiations and settlements arising in connection with a mediation are confidential. This is certainly not the case with formal litigation. If the dispute is a commercially sensitive one, there should be good reasons to keep the information confidential. This confidentiality requirement is enshrined in both the Federal and State legislation in Australia, and is also reflected in the confidentiality agreements that all participants are required to sign before the commencement of a mediation.

7. It is almost infinitely flexible

You can achieve outcomes at a mediation that the court would simply not be empowered to make in formal litigation. Matters such as the future dealings between the parties, as well as apologies, can be incorporated into settlements. It’s entirely up to the participants.

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⁷ *Legal Services Directions 2005*, Appendix B, clause 2(d).

⁸ Eg with the consent of all parties, or to enforce an agreement reached at mediation. For others, see section 31 *Civil Procedure Act 2005* NSW.

8. It's your process and your outcome

In litigation or arbitration, the court or final arbiter makes the decisions and parties often walk away unhappy.

In a mediation, the ultimate decisions that are reached (such as whether or not to settle, and on what terms) are made by the parties themselves. As a result, in most instances the parties perceive both the process and the result to be fair.

9. It minimises risk

A successful mediation should help to minimise risk for the parties, whether that risk be financial, business, reputational, cultural or risk of any other sort.

For example, an early settlement with certainty (or even security) is likely to be a more attractive result than a judgment for a higher sum against an entity that can't eventually pay it because of the cost of the litigation. Further, even in circumstances where you may not have a particularly strong case, you could still have enough to at least negotiate an outcome with the other party that enables you to avoid the risk and cost of formal litigation.

10. It can spread costs

Costs are usually (but not always) shared equally between the parties at a mediation. This is not the usual outcome of a matter that is conducted all the way to a final hearing through the courts, where the 'loser' pays the winner's costs. In contrast, if you are not successful at a mediation, and if that mediation has been ordered by the court, then the costs of conducting the mediation are recoverable as part of the legal costs against an unsuccessful opponent.

What you should know before you mediate

- a) You have to participate in good faith. If it is a court ordered mediation, as an "*officer of the court*" you have a positive obligation to participate in the mediation in good faith. If you fail to do so, the mediator may report you to the court. The question of what constitutes 'good faith' can be a difficult one that requires judgment in each case – it does not give you the luxury of just sitting there with your arms folded, but it also does not mean that you have to accept any offer that is made.
- b) Some parties only ever use mediation as a method to see the weaknesses in your case, and then barrel on to full-scale litigation anyway. It generally becomes obvious that such parties are not at the mediation with any view towards settlement, and they are not participating "in good faith" – see (a) above. You should be prepared to walk away.
- c) The outcome of the mediation is confidential, unless all parties agree otherwise. The practical implication of this is that you cannot provide any settlement details to other parties (such as creditors) without consent.
- d) Any settlement at a mediation should be carefully documented, to ensure it is then enforceable. For example, an agreement that is "an agreement in principle, subject to documentation" is not an enforceable agreement. If at all possible, an enforceable agreement should be completed and signed at the mediation.
- e) Whether the parties agree to go to mediation willingly, or are otherwise ordered to go (often against their will), it is important to recall that approximately 60% of all disputes referred to mediation in the Australian court system settle.⁹ So, even if things look bleak going into the mediation, nationally available statistics suggest that the prospects of settling are still pretty good.

⁹ National Alternative Dispute Resolution Advisory Council *ADR Statistics* 2003.

Conclusion

Litigation is a time-consuming and expensive process, particularly where resources available to insolvency practitioners are limited. It is (usually) not in the creditors' interests for their insolvency practitioner to be engaged in long-winded and expensive litigation. A mediation (or some other ADR process) permits insolvency practitioners to comply with their duties and obligations, and may also result in an early and commercially successful outcome for all parties. Legislation and government policies can be the tool to help get you there, but the rest is up to you.

About the author



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