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The Mediator in Insolvency Law: Exploring New Terrain

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On 11 September 2018, the Court of Appeal of 's-Hertogenbosch handed down a remarkable interlocutory judgment in a case involving the bankruptcy of a tiling company. Although the details of the case are not particularly noteworthy, one paragraph is striking:

On the occasion of this hearing, the Court of Appeal will in any case also want to discuss with the parties whether the parties can reach an amicable settlement in whole or in part, or whether referral to (insolvency) mediation is an option.

This appears to be the first published Dutch judgment in which a court refers to 'insolvency mediation' or an 'insolvency mediator'. Traditionally, experts consider mediation as an adequate alternative dispute resolution (ADR) mechanism, in areas such as family law. However, mediation has received increasing attention within the insolvency practice in recent years. In this blog, we will examine this phenomenon as we will briefly elaborate on what insolvency mediation entails and in which types of disputes during insolvency proceedings it can be utilized. We will then discuss how the European legislature is trying to implement insolvency mediation in the European legislative framework.

Insolvency Mediation

Mediation is a form of ADR in which a mediator assists the parties to find a solution to their dispute. It is initiated on a voluntary basis, as parties themselves decide whether or not they enter into an agreement. Compared to court proceedings, mediation is argued to be more affordable. In addition, it can also be strictly confidential when the mediation process is subject to a non-disclosure agreement, as opposed to public court proceedings.

The use of mediation is not uncommon practice in the Netherlands. In 2017, for example, courts referred almost 1700 family law cases to a mediator. In insolvency cases, however, mediation occurs significantly less often. In literature, various benefits of mediation in this field have been pointed out. The main reason for opting for mediation is considerable cost savings in the event that parties reach an agreement. Especially in larger insolvency cases where procedures can become more complicated, mediation can speed up the process and make it more economical, leaving more value in the estate to satisfy the creditors. In addition, mediation does not have to offer a strict legal solution, as is usually the case when a dispute will be decided by a court. In mediation, parties maintain discretion to set the terms of the settlement agreement together. Finally, according to Draaijer and Van Hees, parties may be more willing to make concessions to reach an agreement in mediation, as mediation would create a 'now or never' feeling.

Promoting insolvency mediation

The potential of mediation in insolvency was also recognised when the European Commission presented its report on the application of Directive 2008/52/EC (EU Mediation Directive) in August 2016. The Commission stated that: '*[o]ne area where mediation remains underdeveloped is that of insolvency proceedings. It should be recalled that in its Recommendation on a new approach to business failure and insolvency, the Commission has encouraged the appointment of mediators by courts where they consider it necessary in order to assist the debtor and creditors in the successful running of negotiations on a restructuring plan.*'

Despite the fact that insolvency mediation has been promoted in the Netherlands for several years, its application remains limited. In 2012, the District Court of Amsterdam commenced a pilot on insolvency mediation. The aim was to investigate whether mediation in bankruptcy proceedings would allow insolvency-related disputes to be solved more quickly and cheaply. In over 70% of the cases, insolvency mediation proved to be a successful solution for the disputes. After the pilot, the District Court of Amsterdam continued to promote mediation in bankruptcy cases. Subsequently, the courts of Rotterdam, Midden-Nederland and The Hague also introduced pilots. Mediation is used in cases involving directors' and officers' liability, disputes between shareholders, and disputes with the tax authorities. The Dutch Insolvency Mediation Foundation keeps a track of well-known bankruptcies in which mediation was applied successfully; for instance, in the cases of V&D and KPN Qwest.

In contrast to the Netherlands, insolvency mediation has a more prominent position in the United States. Court-ordered mediation is a common technique that has proven to be successful in some of the biggest bankruptcies of the previous decades, including Enron and Lehman Brothers. In addition, it is a desirable solution for mass claims that are settled in the context of bankruptcy proceedings. Mediation has proven its added value in these cases by significantly reducing the procedural complexity.

The current limited use of mediation in the European context indicates that there may be some distrust in using mediation in practice. Although the Dutch pilot turned out to be successful in 70% of the cases, there were still 30% of cases in which it was not. No details about those mediation cases are available, which limits the possibility to study the shortcomings of mediation. Critics of mediation, such as Tideman, state that the procedure is not equally suitable for bankruptcy cases in comparison with family law matters. In bankruptcy, the insolvency practitioner may not have the required natural willingness to commence or enter into negotiations led by a mediator, as opposed to cases involving, for instance, two parents who are emotionally involved in the interests of their child and are more likely to achieve a mutual agreement. However, the attitude of the involved parties may be different in (pre-)insolvency proceedings where the debtor is still (partially) in control and the proceedings are aimed at preventing bankruptcy proceedings.

Insolvency mediation from a European perspective

In its efforts to promote a legal framework for preventive restructuring, in March 2014 the European Commission presented a Recommendation on a new approach to business failure and insolvency. It regards in particular the involvement of a mediator and states in Recital 17 that preventive restructuring frameworks should: '*promote efficiency and reduce delays and costs [...] limiting court formalities to where they are necessary and proportionate.*' In addition, it is stressed that mediation '*[...] should not be compulsory, but made on a case-by-case basis*'. The mediator can have a leading role in reaching a compromise between the parties.

Since 2016, the EU legislature has worked on a Directive on restructuring and insolvency(Directive), which was adopted on 6 June 2019. In the first draft of the Commission's proposal for this Directive, the explanatory memorandum to Article 5 elaborated on the possibility of involving a mediator before a debtor is declared bankrupt. The proposal stipulated that, in principle, the debtor must retain control of his assets. The proposal also provided for the option to involve an intermediary – such as a mediator – to assist parties with drafting a restructuring plan. In addition, the mediator was explicitly mentioned in Article 25 of the proposal, which required Member States to encourage the initial and further training as well as the establishment of codes of conduct for mediators dealing with restructuring, insolvency and second chance matters.

In later and final versions of the Directive, explicit reference to a mediator has been removed in favour of the more general term the 'practitioner in the field of restructuring'. With this change, it remains unclear if this terminology still includes the mediator.

However, there are more suggestions to advance the use of mediation in Europe. In 2017 the European Law Institute (ELI) published a report by Prof. em. Bob Wessels and Prof. Stephan Madaus on 'Rescue of Business in Insolvency Law'. This Report contains 115 recommendations on restructuring and insolvency law. Also, mediation and the role of the mediator are discussed in this report. In particular in Recommendation 1.07, it is also recommended that: '*Member States should consider making more explicit provision for the involvement of mediators to resolve restructuring and insolvency disputes. (…).*' It is not just the European Commission, but Member States who can take the lead with respect to the use of mediation in restructuring and insolvency.

Conclusion

Following the United States, insolvency mediation is also on the rise in Europe, and more specifically, in the Netherlands. Mediation is considered an efficient, fast and less expensive alternative to in-court dispute resolution. Several attempts have been made to promote the use of insolvency mediation in practice and in legislation, in particular, in pre-insolvency proceedings where an insolvency practitioner is not yet involved. The Dutch pilot on insolvency mediation has proved promising, although research is still limited. Here, insights from the United States may prove helpful, considering that they have succeeded in developing a professional and experienced practice. Since the EU legislature removed explicit references to mediation in the Directive, it missed an opportunity to provide a clear legal basis for the mediator. Therefore, further development will depend on the national legislatures as well as the insolvency practice.