Mediation as a bankruptcy and insolvency game changer


Bankruptcy Court.pdf

HERO 2024 / B-001

9 januari 2024

Blog

Introduction

While once spoken of as a "future trend", mediation is now actively being used as a key bankruptcy and insolvency tool. In this article, we outline the benefits that mediation can offer in an insolvency scenario. We also consider advances in global policy and regulatory frameworks that will help to shape the central role of mediation as part of a best practice insolvency system, and we identify recent examples where insolvency mediation has been used to achieve optimal outcomes for the benefit of creditors and other stakeholders in significant and cross-border and other cases.

The benefit of mediation in an insolvency scenario

Mediation has a major role to play in enhancing the efficiency of insolvency proceedings, the resolution of multiple creditor disputes and achieving consensus among disparate stakeholders. It can reduce delays and costs—both increasing the prospect of successful restructuring outcomes for viable entities, and producing a better return for creditors.

This is especially the case during the "pre-insolvency" stage—in which a financially distressed but viable business looks to explore options for an informal (or out of court) workout. Particularly in countries that do not have an effective pre-insolvency framework in place and where there is a focus on individual enforcement rather than collectivism, mediation can be a very effective insolvency and restructuring tool.

Further, in a formal insolvency context, a mediator can assist an insolvency trustee or other representative to negotiate with creditors to develop and implement a formal reorganisation plan acceptable to the required majority of creditors. As Justice Ramesh said in his judgment in the Singapore High Court in *Re IM Skaugen SE* [2018] SGHC 259, there is "tremendous utility in deploying the services of a neutral third party skilled in mediation techniques", with a mediator able to "play the invaluable role of building consensus between the debtor and the creditors in the development of the restructuring plan, and to build trust in the process".

Indeed, as noted by Justice Arjan Kumar Sikri—a former Judge of the Supreme Court of India and a current International Judge of the Singapore International Commercial Court—in his recently released book, *Constitutionalism and the Rule of Law in a Theatre of Democracy* (see the cover page included at the end of this article)

mediation can be seen as a form of "democratic decision-making". In that sense, it can function as a key tool in achieving the consensus and creditor majorities inherent in bankruptcy and insolvency regulatory regimes.

Drawing on his experience in India, Justice Sikri has also, in other extra-judicial commentary, noted the way mediation may help to advance creditor negotiations and facilitate the approval of a restructuring plan during a corporate insolvency resolution process (**CIRP**) initiated under India's Insolvency and Bankruptcy Code 2016 (**IBC**) (see "Mediation in Corporate Insolvency: A Game Changer" in *Business World*, 14 June 2019). In doing so, Justice Sikri identifies the way mediation may reduce the delays encountered in practice under the IBC since its introduction, with litigation initiated by parties before tribunals and courts during a CIRP having been cited as one of the primary reasons for delays under the IBC. Justice Sikri also makes the important point that resolution plans agreed to during a mediation process may have the potential to be more innovative and "out of the box" than those arrived at under a typical CIRP.

In both a reorganisation and liquidation scenario, a mediator can also provide procedural cohesion and coordination for complex creditor claims in place of ad hoc enforcement proceedings that could result in years of expensive litigation and diminish property for creditors and any prospect of a successful rescue attempt.

The role of mediation in helping to achieve creditor coordination and consensus can be especially important in cross-border settings. In this context, coordination difficulties among creditors with competing claims in multiple jurisdictions and operating under often very different insolvency regimes are even greater.

Policy and regulatory settings for insolvency-based mediation

Existing frameworks that promote mediation

The use of mediation specifically to enhance informal rescue outcomes is reflected in the principles and policy recommendations released by INSOL International and the World Bank.

A mediator could play a key role within the informal workout framework set out in INSOL's "Statement of Principles for a Global Approach to Multi-Creditor Workouts" (**INSOL Principles**), the second edition of which was released in March 2017. The central idea of the INSOL Principles is that, where a debtor is found to be in financial difficulties, creditors should seek to cooperate with one another to investigate the potential for an out of court negotiated restructuring attempt to reduce costs and maximise the final return. A mediator could help to achieve the creditor coordination envisaged by the fourth principle of the INSOL Principles during an informal restructuring attempt.

Mediation is also a key feature of the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes released in April 2021 (**ICR Principles**). The ICR Principles are intended to distil international best practice to guide countries in their design and implementation of sound and effective insolvency regimes.

Recommendation B4 of the ICR Principles states that "an informal workout may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution". Further, Recommendation D5.4 states that, as part of a best-practice insolvency regime, the legal system should "support and encourage the use of mediation, conciliation and other alternative dispute resolution techniques in simplified procedures" for micro and small enterprises (**MSEs**).

MSE insolvency reform is one of the key issues on the global restructuring and insolvency policy agenda at present, with a view to providing alternative insolvency processes outside the existing "one size fits all" formal insolvency options that typically involve substantial costs and time delays. A mediator could offer a distinct alternative insolvency mechanism for MSEs in financial distress.

Mediation could also play a key role within the cross-border insolvency Model Law framework, particularly in negotiating an insolvency cooperation protocol between courts and insolvency representatives in multiple jurisdictions. The appointment of a mediator in that respect can be seen to fall directly within the form of cooperation contemplated by article 27(a) of the UNCITRAL Model Law on Cross-Border Insolvency (**MLCBI**)—that is, the appointment of a person or body to act at the direction of the court, with a view to discharging the obligations under articles 25 and 26 for courts and foreign representatives to cooperate to the "maximum extent possible" in cross-border matters where recognition and assistance is sought pursuant to the MLCBI.

Future advances

While these existing global policy and regulatory frameworks envisage mediation as a critical restructuring and insolvency resolution tool, there are a number of options to further incentivise the use of mediation in insolvency scenarios.

First, the greater use of mediation in a cross-border insolvency matter could be encouraged through the more widespread adoption and implementation of the Singapore Convention on Mediation, which entered into force on 12 September 2020. The Convention currently has only 56 signatories and 11 ratifying countries.

The Singapore Convention provides an internationally consistent framework for the expedited recognition and enforcement of settlement agreements reached during a cross-border mediation process. This creates an incentive for creditors to pursue negotiated outcomes to settle their claims, knowing that the settlement terms agreed can be enforced simply and quickly.

A precondition to the operation of the Singapore Convention is the existence of a mediation settlement that arises from a "commercial dispute" in an international matter. Arguably, in a cross-border insolvency matter, there would be an element of a commercial dispute insofar as different creditors negotiating with a debtor in a workout context each have their own distinct claims and, notionally, seek repayment of their entire debts—creating a dispute with the debtor, which necessarily may not be able to pay all those claims in full.

Further, the Singapore Convention does not apply to settlement agreements approved by a court or concluded during proceedings before a court. If insolvency proceedings have already been opened, would any mediator-led negotiated restructuring plan (or resolution of creditor disputes) be considered a settlement agreement arising "in the course of proceedings before a court"? Arguably, this condition ought to be construed more narrowly, so that it applies only if the specific subject matter of a creditor's claim had already been the focus of a court proceeding commenced before the relevant insolvency—and not where the relevant "proceeding" is a collective insolvency process involving the debtor. In any event, an informal workout plan (reached outside of a formal insolvency filing) would not be subject to any interpretational doubt.

Aside from the Singapore Convention, the introduction of new court procedural rules in local jurisdictions could support the use of mediation in insolvency matters, by providing courts with the power to refer the parties to mandatory mediation at any point of an insolvency process. Rules of that kind are currently very limited globally, with the United States being a notable exception. There, 40 of the 90 United States Bankruptcy Courts now permit, by rule or standing order, a bankruptcy judge to order the parties to a dispute to attempt mediation. In the Delaware Bankruptcy Court, a mandatory mediation program for adversary proceedings has been in place since 2004. The American Bankruptcy Institute also released in February 2015 its "Local Bankruptcy Rules for Mediation" as a resource for bankruptcy courts in adopting or revising local bankruptcy rules regarding mediation.

To ensure trust and confidence in the mediation process from creditors (thereby incentivising creditors' use of mediation in an insolvency and restructuring context), it is also important to have skilled professionals with insolvency and restructuring expertise as the eligible individuals entitled to act as mediators. This should ideally take place through a registration system. For example, there could be an additional registration qualification added to the existing registration systems for registered liquidators and other insolvency practitioners that operate in various jurisdictions across the world. It would also be optimal for there to be a common international framework for registration to bring cohesion and a degree of "quality control" given the disparate systems that operate in local jurisdictions and the importance of having a trusted process in cross-border insolvency matters. As Justice Sikri aptly notes in the context of encouraging the use of non-adversarial methods in resolving disputes across borders, "efforts must be made by the legal and regulatory framework to provide comfort to investors, especially foreign investors" (Justice Arjan Kumar Sikri, *Constitutionalism and the Rule of Law in a Theatre of Democracy*, EBC, 2023, 432).

Mediation examples in large cross-border and other insolvency cases

There are some high-profile examples which demonstrate the benefit mediation has had in achieving more efficient outcomes in cross-border insolvency proceedings.

In MF Global Holdings, for multiple entities undergoing competing insolvency processes in the United States and the United Kingdom, a court-appointed mediator

helped to facilitate agreements between the United States bankruptcy trustees and the special administrators of MF Global in the United Kingdom, which avoided expensive litigation and produced a global settlement maximising returns for creditors.

In Lehman Brothers Holdings, the United States Bankruptcy Court appointed mediators to assist in the resolution of complex disputes with approximately 250 counterparties. Of the 77 proceedings reaching the mediation stage, 73 were settled in mediation and only 4 terminated without settlement. In financial terms, the settlements achieved through mediation in Lehman Brothers are estimated to have led to the recovery of over US$2 billion in additional proceeds for distribution to creditors.

In 2020, the United States Bankruptcy Court appointed Judge Drain as mediator in China Fishery Group's Chapter 11 case. The restructuring plan was confirmed in June 2021, and this was only possible through the success of mediation in narrowing and resolving the web of complex trade finance claims.

The use of mediation to resolve cross-border insolvency and restructuring matters can be expected to continue in coming years with the growing complexity of the substantive legal matters that will come before bankruptcy and insolvency courts. Notably, there will be an important role for mediation in centralising and bringing cohesion to proceedings involving mass tort claims.

The valuable role of mediation in that context was seen in the Boy Scouts of America bankruptcy in the United States. Boy Scouts, which filed for Chapter 11 in February 2020, faced, among other claims, 82,209 unique claims alleging "scouting-related" sexual abuse. In this case, three court-appointed mediators, including a former bankruptcy judge, played a pivotal role in negotiating and resolving an array of disputes that paved the way for Boy Scouts to obtain confirmation of its Chapter 11 reorganisation plan in September 2022, with the plan becoming effective in April 2023.

The cornerstone of Boy Scouts' reorganisation plan is a series of mediated settlements resolving a complex array of overlapping liabilities and insurance rights and the establishment of trust distribution procedures to administer the largest sexual abuse compensation fund in United States history: a settlement trust that will provide non-contingent funding of US$2.48 billion in cash and property, in addition to other assets, including insurance rights, to benefit abuse survivors. In exchange for making financial or other insurance contributions to the settlement trust, Boy Scouts, local councils, contributing chartered organisations and settling insurance companies receive the protection of a non-consensual release of tens of thousands of abuse claims, which are channelled to the settlement trust. The trust distribution procedures implement a process through which abuse claims will be reviewed and valued by the settlement trust based on the nature of the abuse. The settlement trust will also be entitled to pursue additional recoveries for the benefit of abuse survivors against non-settling parties, including several chartered organisations and insurance companies.

In its Opinion issued on 28 March 2023, the Delaware District Court noted there were thousands of hours of mediated negotiations during the Chapter 11 proceedings, and the mediators managed to secure support for the final reorganisation plan from every estate fiduciary and nearly every organised creditor group. The Court called this "a commendable result for such a lengthy, contentious and emotionally charged proceeding".

While mediation did not resolve the *substance* of the abuse claims, it did maximise *procedural* efficiency by channelling claims into a centralised trust assessment and distribution process to take place, in the first instance, out of court, and mitigating the considerable costs that would be incurred in resolving each individual claim in a court-based, adversarial setting.

Conclusion

Mediation has a significant role to play in coordinating the claims of disputing creditors in an insolvency context and guiding creditors towards a successful restructuring outcome. Mediation is also a valuable means to achieve court-to-court cooperation and communication in cross-border insolvency matters.

The use of mediation in an insolvency setting has, to date, had the strongest uptake in the United States, where mandatory court referral powers to mediation in bankruptcy matters are common in many courts and have been frequently utilized in Chapter 11 cases. Extending these powers in other jurisdictions is one way to incentivise the growth of mediation as a viable insolvency resolution tool—as well as encouraging the further adoption and implementation of the Singapore Convention to provide an internationally-consistent framework for the enforceability of mediation settlement agreements in a cross-border insolvency matter.

This article was previously published on the website of Norton Rose Fulbright

Auteur(s)

Scott Atkins
Global Chair and Global Co-Head of Restructuring at Norton Rose Fulbright
LinkedIn

NORTON ROSE FULBRIGHT

Kai Adam Luck
Is a Special Counsel at Norton Rose Fulbright
LinkedIn