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Mediation meditations: Understanding the mediation culture of Chapter 11

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Mediation of plan related disputes has become an accepted feature of chapter 11 practice. Routinely, mediation is ordered by bankruptcy judges, requested by debtors and other parties in interest and viewed by market participants as an option worth considering to save time and expense and to build consensus in complex chapter 11 cases. This article describes the fertile mediation culture within US bankruptcy practice and offers some of the author's perspectives and insights on this culture and the benefits of plan mediation.

The appointment of mediators to address plan related issues in chapter 11 cases is on the rise, and for good reason. Mediation advances the aims of reorganisation and functions as a counterpoint to pursuing ongoing litigation in bankruptcy court. Mediation and bankruptcy court litigation complement each other and offer alternative approaches to resolving disputes that impact distribution rights. Mediation of plan issues has become increasingly popular given the potential for cram down litigation to become an expensive and protracted slog with a propensity to also be value destructive.

Mediation culture — a byproduct of litigation culture

A culture of mediation is a natural response to a culture of widespread litigation: chapter 11 practice in large cases often follows a Newtonian pattern of action and reaction. The action is an assertion that advances the position of a particular creditor or group in relation to a subject where legal entitlement is unsettled and the process of resolution has the potential to be time consuming and expensive. The reaction is a vigorous defence that makes the litigation more contentious and disruptive.

We all know that high stakes litigation in large bankruptcy cases can be dreadfully expensive, time consuming, burdensome, distracting, wasteful and uncertain, especially when appeals are factored into the analysis. While parties may have good reason to be aggressive and to press for a judicial resolution to obtain definitive answers to unsettled legal questions or pivotal factual controversies (such as valuation), litigation necessarily will end in a binary

outcome of victory or defeat. That harsh result means that certain self-assured litigants will suffer foreseeable economic loss.

Someone in this setting – it could be the court or one of the parties – may suggest that the dispute might be efficiently resolved in mediation. My own empirical experience tells me that mediation is on the rise in direct proportion to an increase in aggressively contested legal issues that impact recoveries in chapter 11. My thesis is that plan mediation has grown in importance in chapter 11 cases because of the need to manage outbreaks of hostility that distract from the collective goals of reorganisation that depend on compromise. I believe that mediation is especially valued in a culture that also recognises the adverse consequences of unchecked litigation.

Given this manifest need for a moderating influence, the bankruptcy community in the United States has adopted plan mediation as a desirable option in chapter 11 cases where neutral evaluation or some external pressure to consider compromises may be needed. Mediation as an alternative dispute resolution technique has been around for a long time, especially in civil litigation. What has changed in recent years is the expanded use of this familiar approach in negotiating key provisions of chapter 11 plans.

Not every situation calls for mediation, and often parties are capable of reaching resolution on their own, but in those situations where communications have broken down and positions have hardened, it has become quite common for bankruptcy judges or parties in interest acting on their own to think seriously

about bringing in a mediator. A fresh perspective from an authoritative and respected neutral observer can soften obdurate positions and encourage productive bargaining.

The obvious advantage of mediation is that parties have recourse to an intermediary to help in structuring an agreed settlement of their disputes in a manner that saves time and expense and manages risk. From the perspective of the debtor business and all stakeholders, a consensual restructuring obtained as a result of a successful mediation is a highly desirable outcome. That is true for the court as well. A settlement unburdens the court, saves time, avoids costs and may also maximise enterprise value.

Plan mediation as a process

The plan mediation experience will vary from case to case depending on the personality and style of the mediator and the nature of the issues in dispute, but mediation, especially in relation to negotiating a reorganisation plan with multiple parties, has proven itself to be an extremely effective way to achieve largely consensual outcomes in complex chapter 11 cases.

Word has gotten around that mediation is well suited to chapter 11 negotiations. The fact that mediation has been used successfully to resolve tenaciously tough disagreements (e.g. Residential Capital, Nortel, Toisa Limited) is no secret within the bankruptcy community.² Bankruptcy courts and parties alike have warmed to the idea of using mediators in appropriate settings.

Mediation is widely accepted and has been utilised successfully at various stages of the chapter 11 case to address and solve a multitude of legal and business problems. The process is usually voluntary and informal and takes place without active judicial intervention, but the parties all know that the court is an interested observer, rooting on the sidelines for a successful outcome. Knowing that the court is paying attention encourages mediation parties to be on their best behaviour.

Judges and stakeholders alike appreciate the virtues of a process that saves time and money, reduces the burden on courts and produces restructuring agreements that advance the essential reorganisation aims of chapter 11. Mediation may not be the right solution in every

case, but a skilled mediator is often what is needed to break bargaining logjams and to initiate constructive negotiations, especially when parties have become entrenched in their positions and are convinced that they are entitled to a certain result.

Bringing in a perceptive and commercially savvy neutral party changes the bargaining dynamic in a case such as that. The mediator can be the catalyst who helps to refresh attitudes, modify dysfunctional bargaining behaviors and cajole mediation parties to open their minds and to listen more carefully to other points of view. Mediators with restructuring expertise and a good bedside manner may be capable of bringing new perspectives to persistently difficult partisan disputes.

That refocusing of the dialogue can be exactly what is needed to persuade hostile parties who are far apart to reconsider their litigation postures. A freshened outlook on the controversy expressed by an unbiased third party can help to identify the commercial benefits of a compromise of disputed issues as well as the adverse commercial consequences of a failure to reach an agreement. The introduction of a skilled mediator should be seen as a positive development potentially leading to good faith bargaining.

The mediator can offer his or her views on the bankruptcy case, predict what the court is likely to do if parties are unable to settle their differences, evaluate the legal and business issues in dispute and provide guidance and a new sense of momentum to the plan negotiations. The mediator can privately examine the motivations of each group and thereby help to improve mutual understanding and encourage a more realistic assessment of the risks of a failed mediation and the rewards of a successful one.

An effective mediator functions as a coach, a cheerleader and a referee who is able to open pathways to constructive communication and increased mutual understanding. A mediator who can earn the trust and respect of the parties also becomes a stabilising force within the chapter 11 case and a source of new ideas and possible solutions.

An engagement in a tough case calls for a full-time commitment of the mediator's energy and creativity. The mediator will communicate

with mediation parties before, during and after formal mediation sessions. There is nothing static about the exercise. Separate meetings and telephone calls are scheduled regularly with the singular goal of keeping the parties talking and thinking about ways to compromise their differences within a collective proceeding. Bridging the gap in negotiations requires relentless attention to the parties and to the issues being mediated.

The issues and personalities of course will vary from case to case, making each mediation engagement unique. Some are more challenging than others, but there are some common elements. These include identifying the issues clearly, talking through those issues to improve communications and highlight any areas of agreement, a confidential neutral evaluation of the strengths and weaknesses of the positions of each mediation party, promoting increased awareness of the costs and risks of a failed mediation, and helping parties recognise the mutual benefits of compromise, leading potentially to the building of consensus and the alignment of competing interests.

Ultimately, the process has the potential to bring about the effective reorganisation of businesses in a manner that avoids the delay and expense of unresolved litigation and exposure to the risks of an adverse judicial decision. Nothing about effective mediation is the least bit scientific. Mediation involves more emotional intelligence than math skills, and a successful resolution often will grow out of a contagious deal momentum that propels the parties to a favorable conclusion. The entire process requires patience and persistence – and occasionally some raised voices, slammed doors and banging on conference room tables.

The areas of possible conflict that may be resolved in mediation are varied. Often the issues will relate to valuation, priority and claim allowance questions and disagreements concerning the proper interpretation of provisions in loan agreements or indentures or the application of a particular legal doctrine that might expose a party in interest to liability or a loss of priority. Legal uncertainty is a common theme in plan mediations, and a probability weighted or risk adjusted analysis is a tool frequently used by mediators to

illustrate the benefit of a compromise that fairly accounts for the likely outcome of a disputed issue.

Mediation is meant to be opaque

There is a conflict between the public nature of proceedings in a chapter 11 case and the privacy required by the mediation process. Bankruptcy functions in a fishbowl of disclosure and discovery while a plan mediation, especially where material nonpublic information is involved, is premised on the secrecy of the proceedings.

That secrecy is necessary and encourages a candid exchange of views and active good faith bargaining. The confidentiality of the process is imposed by court order or by terms included in a mediation agreement. The mediator is charged with the duty to act as the proverbial honest broker and will disclose what has been shared in confidence only with permission of the party who has entrusted the information.

The mediation itself is entirely off the record in a case in which everything ordinarily is openly and conspicuously disclosed. Given the public interest in the outcome of the plan process, there is obvious tension between the confidentiality needed to maintain the purity of the mediation process and the ordinary requirements of full disclosure to parties with economic interests in the bankruptcy case.

Choosing a mediator is not so easy

Potential mediators are often screened in advance by the parties based on the reputation and experience of the mediator and thoughts as to whether a particular mediator's style and personality will fit the needs of the disputes to be mediated. Sitting bankruptcy judges are frequently favoured candidates for the role of plan mediator.

Parties may decide among themselves that a particular judge might be right for the assignment, but such wishes are not routinely granted. Sometimes the subject is discussed in a chambers conference with the court to test the waters. That informal approach may be followed by a motion asking the court to appoint a colleague to serve as plan mediator. Depending on the needs of the case and the views of the

presiding judge, such requests may or may not lead to the appointment of another judge as mediator, and there is no way of predicting the outcome.

The presiding judge may regard the plan-related disputes in question as particularly challenging and foreseeably so time consuming that it would be burdensome to impose on another sitting judge. That will lead to the decision to appoint a private mediator who may be a seasoned practitioner or a retired judge. Parties are given the opportunity to select a mediator or the court may make a selection from an approved list. In cross-border cases, the list may be one maintained by INSOL International, the Singapore Mediation Centre, or other organisations in the field.

If the dispute requires immediate attention, the preferred candidates may not be available, leading to the possible need to compromise demands as to timing or as to the choice of mediator.

Timing matters

For plan mediation to have the best chance of bringing parties together, there needs to be a shared recognition that the time has arrived for serious bargaining. A very recent example from the Southern District of New York illustrates the point.

From the earliest days of the Pacific Drilling case filed late in 2017, creditors of this ultra-deep-water offshore drilling company and the bankruptcy court have talked publicly about the problem of how to fairly allocate plan equity and declared an interest in mediation as a means to promote meaningful dialogue over plan terms. In an unusual development, the question of the right time and circumstance for such a mediation became the subject of a hotly contested matter.

Creditors moved for an order directing plan mediation, and that motion was vigorously opposed by the debtor and the controlling equity holder as premature, both arguing, among other things, that it was too early for mediation and that the debtor needed more time to negotiate on its own in order to narrow the issues during its exclusive period to propose a plan. The bankruptcy court recognised that more preliminary work needed to be done before ordering mediation and adjourned consideration of the motion for several weeks.

At a hearing on March 22, 2018, the bankruptcy court tied plan mediation to an extension of the exclusive period for the debtor to propose a plan. The court resolved these two related contested matters by extending the exclusive period to the earlier of 60 days from the date of entry of the court's order or two weeks after termination of the mediation and by conditioning the extension on appointing the author of this article as mediator. This ends a particularly difficult fight over the appointment of a mediator, and it remains to be seen if a mediation conducted in the shadow of so much antagonism will be successful.

The international angle: Mediation as an export

As shown in this article, bringing a mediator into the middle of restructuring negotiations has become a relatively common practice in the US, yielding measurable results. This positive experience implies that there might be a demand for mediation services in other jurisdictions.

Parties involved in complex restructurings in other parts of the world might consider bringing in a mediator, perhaps a retired judge or another respected senior level practitioner within the local professional community, to help with the negotiation of consent solicitations, exchange offers or schemes. The process that has worked well in the US may travel well and have potential applications, regardless of the insolvency regime, in situations where parties are confronting a distressed business and are unable to reach agreement on their own.

Recent experiences validate the utility of plan mediation

My own experience is indicative of the benefits of plan mediation to parties and the bankruptcy system. Six years ago, I was asked to mediate labour disputes in the American Airlines case. A series of significant cases followed while I was still on the bench, including plan mediation in MFGlobal and Residential Capital.

In these and other cases, I found that my involvement as a neutral party advanced the negotiations and lead to successful outcomes. More recently, I served as plan mediator in Toisa

Limited, a chapter 11 case with multiple lenders located throughout the world. The mediation helped to focus and guide the thinking of the lenders and the company's owner and ultimately yielded a favourable resolution that would not have been attainable otherwise.

These experiences provide empirical support for the proposition that mediation is a practical and valuable alternative to the adjudication of disputes and can be extremely useful in promoting the objectives of reorganisation for the benefit of all interested parties.

Conclusion

The author is convinced based on his experiences with plan mediation, both as a judicial mediator while serving on the bench and lately as a retired bankruptcy judge retained privately with court approval, that engaging a mediator is a productive means for parties to achieve a highly desirable result that may not be attainable in the absence of such intervention. Problems large and small are resolved in mediation that would otherwise distract the parties and occupy the courts, manifestly benefiting stakeholders and the judicial system.

Notes:

¹ James M. Peck served as a US Bankruptcy Judge for the Southern District of New York from 2006 to 2014. During his judicial service, former Judge Peck presided over the chapter 11 and SIPA cases of Lehman Brothers and its affiliates and a number of other major chapter 11 and chapter 15 cases. Former Judge Peck has extensive experience as a mediator of sophisticated commercial disputes. As mediator, he has

brokered settlements in a number of high-profile cases, including American Airlines, Syms/Filenes, MF Global, General Motors, Residential Capital, Excel Maritime, Toisa Limited, and Mesabi Metallics. Former Judge Peck is a qualified member of mediation panels maintained by INSOL International, the Singapore Mediation Centre, the Singapore International Mediation Centre, and the Hong Kong International Arbitration Centre.

² In recent years, mediation has also been used to reach largely consensual, global resolutions in the "mega" chapter 11 cases of Cengage Learning, Excel Maritime Carriers, and Tribune, among others, and in the major municipal bankruptcy cases of the City of Detroit, Michigan, the City of San Bernardino, California, and the City of Stockton, California. A team of five judicial mediators also has been appointed to facilitate the negotiation of a plan of adjustment to address the overwhelming obligations owed by the Commonwealth of Puerto Rico.

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