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Mediation Matters

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The Use of Mediation in Large Chapter 11 Cases: Useful, Voluntary and Mandatory (Part I)



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Bankruptcy is a world of balance, compromise and economics, and is often a perfect venue to foster and encourage the use of mediation in various stages of the reorganization process. Good bankruptcy lawyers are likewise skilled deal-makers who bring together diverse factions, achieve consensus, secure votes or buy-in, and emerge with a consensual plan or approach to a process.

Mediation is highly prevalent in chapter 11 practice. In a 1998 survey, only 9 percent of mediators reported that their chapter 11 mediations involved negotiating a confirmable plan.¹ In a 2009 survey, 81 percent of judges reported using mediation in their chapter 11 cases in some capacity.² Strikingly, 51 of 158 judges surveyed in 2009 reported that plan negotiation was the *most common* reason for mediation.³ Several responding judges employed plan-related mediation, fueling an increase of at least 300 percent in plan-mediation use from 1998-2009.

Since 2009, mediation use has only grown. However, without personal familiarity with the cases, the prevalence of mediation is sometimes hard to track. Of the 15 large chapter 11 cases filed in the Southern District of Texas,⁴ only two involved docketed mediation orders. (These docketed mediations show the diversity of issues being mediated.) Even in the same case, mediations may address traditional issues, such as claims-estima-

tion,⁵ and nontraditional mediation issues, such as franchisor consent to assignment.⁶ Mediations might also include parties somewhat tangentially related to the disputes, such as the representatives of a class whose tax status might be affected by a plan.⁷

An analysis of mediation that begins with the docket will inevitably fall short, as mediation often takes place in informal ways, and plan negotiations may begin long before the formal filing even occurs. Thus, mediation (formal or informal) often starts before the petition has even been filed — an underappreciated part of plan negotiations.

This article is the first of a two-part series about the various stages where mediation occurs and has been useful in cases. Part II will address more traditional and well-covered uses of mediation and how mediation is raised by the parties, highlighting nuances and lesser-studied issues.

Pre-Filing Mediation: Prenegotiated Chapter 11 Plans

In prenegotiated chapter 11 cases, parties can begin negotiating a plan pre-petition, but the actual solicitation occurs post-petition. Before filing, the initial goal is to get a group of stakeholders on board with an agreement to facilitate a smooth transition into bankruptcy. This approach is also intended to encourage a more immediate exit from bankruptcy through a restructuring-support agreement (RSA), also called plan-support agreements.

1 Ralph Peeples, "The Uses of Mediation in Chapter 11 Cases," 17 *Am. Bankr. Inst. L. Rev.* 401, 406 (2009), available at abi.org/members/member-resources/law-review (unless otherwise specified, all links in this article were last visited on June 30, 2023).
2 *Id.* at 417.
3 *Id.* at 418.
4 The Southern District of Texas had 15 families of jointly administered cases with more than \$100 million in liabilities since January 2020, as shown in a Lex Machina search performed on June 16, 2023.

5 Agreed Mediation Order for Estimation of Driver Claimant's Claims, *In re NPC Int'l Inc.*, Case No. 20-33353 (DRJ) (Bankr. S.D. Tex.), Docket No. 1113.
6 Agreed Mediation Order, *In re NPC Int'l Inc.*, Case No. 20-33353 (DRJ) (Bankr. S.D. Tex.) Docket No. 1195.
7 Response to Motion to Appoint Mediator, *In re GWG Holdings Inc.*, Case No. 22-90032 (MI) (Bankr. S.D. Tex.), Docket No. 1248.

Mediation is an option to get remaining key parties on board with an RSA-backed plan.

Parties may attempt to engage in negotiations on their own; after all, bankruptcy lawyers are deal-makers. However, depending on the number of constituents involved and divergent interests, a neutral without skin in the game could do better by bringing interests to the forefront. Sometimes, even the best professionals get entrenched in their client's position after months or years of advocacy and need the help of a third party to counterbalance their perspective. A mediator can help the parties reset and cross the final bridge to a negotiated solution.

Pre-filing negotiations are private-party mediations where no court order yet governs the mediation conduct and process.⁸ First, the parties should ensure that they have a robust agreement on confidentiality and treatment in litigation when the case files.⁹ Second, parties should consult applicable statutes and rules, both those governing the mediation agreement and those of the target bankruptcy court. For example, Delaware Bankruptcy Court Local Rule 9019-5(d) provides a detailed guide on what can be mediated, how costs are allocated and the extent of confidentiality over mediation communications. In contrast, the Local Rules for the U.S. Bankruptcy Court for the Southern District of Texas do not mention mediation or alternative dispute resolution.

Post-Filing Mediation: In It to Win It

Once a case has been filed, where debtors have partial buy-in to a process or a plan from a significant constituent group but still need more buy-in, they may immediately ask the bankruptcy court to appoint a mediator to help garner consensus. It is possible to deploy parallel tracks under an aggressive plan process if timelines are important to moving the case along. One critical advantage of mediation is that most mediators will address disputes quickly. This is true whether the mediator is a local judge sitting as a favor to another judge, or a panel mediator: They all recognize that bankruptcy moves quickly.

It is fairly common to face opposition to a fast-moving plan process. Where a debtor seeks a quick restructuring or sale, delay can be a friend to those who want a better deal. Parties may turn to a mediator to promote consensus among strong adverse factions. For example, this may include an unsecured creditors' committee that stridently opposes the plan or is holding out for significant dollars or specific pieces of the pie; a lender looking for something in confirmation; or other well-organized claimants. These headwinds could prove most challenging in mass tort cases.

To mitigate delay tactics, mediations with these factions often progress in parallel with major case events (*e.g.*, approval of a disclosure statement or plan confirmation). This way, despite the "hold up," the upcoming trial or potential rulings may keep the parties engaged in a substantive result in the mediation, thereby avoiding pushing the envelope too

far. In LTL Management LLC's first bankruptcy, the court used parallel tracks by setting estimation hearings with mediation moving along at the same time.¹⁰

Some mediations may involve the court for briefing and trials teed up at the same time. However, the best economics seem to exist when mediation comes first to save on the estate costs and resources of all parties concerned. Even if mediation fails or is unsuccessful in that moment, all the work put into mediation statements, analysis and related pleadings might morph into briefings for the next stage of the litigation process. Thus, anyone who truly and properly prepares for mediation has not "wasted time." (An optimistic mediator would even say they have laid the groundwork for a later settlement). Merely the pressure of a pending trial, deposition or court ruling may force holdout constituencies to resolve matters.

Mallinckrodt: Mediation Wins the Day

Mallinckrodt's bankruptcy involved many mediations with varying dynamics. It is not the only recent chapter 11 case to emphasize mediation, but it serves as a good example. Pre-petition, the debtors negotiated an RSA with secured noteholders and certain governmental entities regarding opioid liability. On filing, private opioid claimants were not decisively onboard with the RSA, and neither were general unsecured creditors. Separate official committees were formed for opioid (OCC) and nonopioid unsecured creditors (UCC), and both expressed serious reservations about the initial proposed plan.

The OCC engaged in mediation with the debtors to address the amount that opioid creditors would be paid and how those funds would be divided among the different opioid constituencies: the federal government, states, individuals, companies and future claimants. This mediation resulted in a modest increase in funding for opioid trusts and an allocation of how that funding would be divided among the constituencies. The OCC later supported plan confirmation.¹¹

The UCC engaged in mediation with a different starting posture: Many large claims were subject to the debtors' objections, and the plan only allocated approximately 8 percent of the distributions to UCCs. Mediating before Hon. **Christopher S. Sontchi** (ret.), the UCC obtained a 40 percent increase in funding for the eventual UCC liquidating trust, deferral of the claims objections not already adjudicated, and an allocation of the trust corpus among different types of nonopioid general unsecureds based on a complex debtor-by-debtor valuation waterfall. The UCC also supported the plan.¹²

The confirmed plan featured separate trusts for opioid creditors and nonopioid general unsecureds. The trust documents governing these entities also require mediation, within certain limits. For example, mediation could resolve disputes between different opioid creditors within defined constituency groups, without creditor-on-creditor violence in

8 For example, after dismissal of its first bankruptcy case, LTL used mediation to accomplish plan-support agreements that form the core of its second chapter 11 filing. See First-Day Declaration of John K. Kim, *In re LTL Mgmt. LLC*, Case No. 23-12825 (MBK) (Bankr. D.N.J.), Docket No. 4 at ¶¶ 72-74. Here, although private, the parties leveraged the mediation orders from the first bankruptcy case.

9 Leslie A. Berkoff & John G. Loughnane, "Limitations on Confidentiality," *XLI ABI Journal* 9, 26-27, 47, September 2022, available at abi.org/abi-journal.

10 Order Appointing Estimation Expert, *In re LTL Mgmt.*, Case No. 21-30589 (MBK) (Bankr. D.N.J.), Docket No. 2881.

11 Declaration of Michael Atkinson in Support of Confirmation, *In re Mallinckrodt plc*, Case No. 20-12522 (JTD) (Bankr. D. Del.), Docket No. 5319.

12 Declaration of Mark Greenberg in Support of UCC Plan Settlement, *In re Mallinckrodt plc*, Case No. 20-12522 (JTD) (Bankr. D. Del.), Docket No. 4644.

a claims-objection process.¹³ Mediation within the separate general unsecured claims trust is a mandatory first step for certain general unsecured constituencies for any dispute over the liquidation of claims.¹⁴

In *Mallinckrodt*, this series of mediations produced a confirmed plan with the consent of most major parties, reducing the complexity of the confirmation hearing and obviating most preconfirmation claims objections. After confirmation, the plan and trusts then rely on mediation to preserve the trust assets against depletion via administrative expenses.¹⁵

Post-Confirmation: Mediation Stays the Course

Post-confirmation mediation may address how funds are distributed to various constituents. Mediation is often deployed to address the limited funds that a debtor must pay creditors. In a liquidating case, this is a pot of diminishing returns, as there is only so much money, as opposed to a reorganizing entity with the ability to potentially add value through ongoing operations. The more parties fight, the less money there is to pay to creditors. Some liquidation trusts use a dwindling pot to corral disputes into mediation. The *Mallinckrodt* general unsecured claims trust required a party to move before the bankruptcy court if it wished to escape mandatory mediation.¹⁶ This imposed a meaningful cost even on an attempt to avoid a foray into the mediation process.

In liquidations, mediation is an economic tool to efficiently resolve claims vs. litigation. If used correctly, mediation is a good way to reduce the costs associated with claim allocations. A properly structured trust run by a conscientious trustee will seek to allocate the limited pool of funds to valid claimants, obtain a global settlement, and make a quicker disbursement without the necessity of many claims objections.

This issue becomes complicated when dealing with § 502(h) claim waivers or claim waivers in general.¹⁷ Splitting trusts into different buckets can make negotiating resolutions difficult. Good trust design should anticipate subsequent mediation and negotiations around claims disputes and allocations. For example, if one trust governs creditor distributions and another trust governs claim objections, then claim waivers are not really relevant when negotiating resolutions to adversary proceedings (*i.e.*, trading claim waivers to reduce payment of funds back to the estate).

Adversary Proceedings: Mediation and Economics

Even outside bankruptcy, most courts have recognized that burgeoning litigation costs cry out for mediation. Many parties and courts turn to alternative dispute resolution to

minimize litigation costs, streamline processes and expedite resolution. Given the comparatively short timelines used by bankruptcy courts and restructuring professionals, mediation is often at the top of a solution pile — if used effectively and appropriately to control costs and timelines.

Not every commentator is convinced that mediation in the plan context is the shortest, fastest route to resolving mass tort claims, although many practitioners and bankruptcy courts believe that it is. This may be a gut call until more empirical evidence becomes available. Facially, mass tort bankruptcy cases have high price tags that are hard to compare with a realistic nonbankruptcy litigation approach.

To be clear, one size does not fit all. Matters must be litigated, and the individual in the black robe must decide the case. However, there are often other options available, including mediation, if the parties look past their war shields.

Conclusion

Mediation is a flexible and well-accepted tool used during every phase of the plan-formulation process, from pre-filing to post-confirmation and beyond. The efficacy of mediation is that it often works in parallel with main proceedings, focuses on specific parties and objections, and promotes consensus in a private or semi-private environment. Mediation is also enormously flexible and can accommodate nearly any proceeding format, including the heavy use of remote-appearance technology.

The power of mediation as a core part of the plan process has most recently been shown in most, if not all, recent mass tort cases such as *Mallinckrodt*, *LTL Management*, *Purdue Pharma*, *Boy Scouts* and *USA Gymnastics*, among others. Mediation is often essential to achieving a confirmed plan, but the systemic use and its efficacy remains poorly tracked and measured. In addition, some orders and practices severely limit basic factual disclosures.¹⁸ Working with courts and practitioners to provide metrics on the uses of and types of mediation processes would help with further research and findings.

Part II of this series will return to the familiar territory of mediation use in preference and avoidance actions and other adversary proceedings about claims allowance, going beyond the usual and highly covered topics. The authors will share insights in Part II on such less frequently discussed issues as the effects of mandatory mediation on creditors, mediator-selection practices and limitations, and court-ordered mediation practices. **abi**

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¹³ Opioid Trust Governing Documents, *In re Mallinckrodt plc*, Case No. 20-12522 (JTD) (Bankr. D. Del.), Docket No. 7684.

¹⁴ General Unsecured Claims Trustee's Procedures for Disputed General Unsecured Claims, *In re Mallinckrodt plc*, Case No. 20-12522 (JTD) (Bankr. D. Del.), Docket No. 7684.

¹⁵ As of June 2023, Mallinckrodt is encountering some difficulties in performing its funding obligations. See Lauren Berg, "Mallinckrodt Considers New Bankruptcy over Opioid Payment," *Law360* (June 5, 2023), available at law360.com/articles/1684983/mallinckrodt-considers-new-bankruptcy-over-opioid-payment (subscription required to view article). No matter the outcome of these difficulties, it still serves as a useful example of the various mediation dynamics in large cases.

¹⁶ See *supra* n.10.

¹⁷ 11 U.S.C. § 502(h).

¹⁸ Order Establishing Mediation Protocol, *In re LTL Mgmt.*, Case No. 21-30589 (MBK) (Bankr. D.N.J.), Docket No. 1780 at ¶ 4(k), limiting disclosure of basic facts about the mediation except with the express written authorization of the mediators. The amended mediation order replaced this paragraph with a comprehensive multi-part section on confidentiality. *Id.* at Docket No. 2300 at 5. This restriction is in addition to other confidentiality provisions in protective orders or other agreements. See Order Entering Agreed Protective Order, *id.* at Docket No. 948.