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Mediation Matters

By Leslie A. Berkoff, Candice L. Kline and Turner N. Falk

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

Coordinating Editor
Leslie A. Berkoff
Moritt Hock & Hamroff LLP; New York

Candice L. Kline
Saul Ewing LLP
Chicago

Turner N. Falk
Saul Ewing LLP
Philadelphia

A previous article[1] discussed the rising prevalence of mediation in large chapter 11 bankruptcies, especially its use in previously rare scenarios such as plan confirmation. Part II considers a more traditional mediation topic: adversary proceedings.

Traditional Topics of Mediation

While adversary proceedings in bankruptcy can address a variety of causes of action, avoidance claims are possibly the most common. In an avoidance proceeding, a party — the trustee, debtor or post-confirmation trust — seeks to unwind transactions that took place before the bankruptcy filing and while the debtor was insolvent or under the statutory bankruptcy construct of a preference. In large bankruptcy cases, it is common for dozens, or even hundreds, of avoidance actions to be filed, usually on the same day, often to toll or meet a statute of limitations.

Avoidance actions are knotty because the plaintiff, who has access to the debtor's books and records, may readily establish the elements of a *prima facie* case by determining when the debtor became insolvent and subsequent transfers occurred. Relevant in preference actions is the waterfall of the debtor's assets; again, this is information that may be known only to the plaintiff. However, the numerous complex defenses to avoidance actions are usually fact-specific and often rely on facts that are available to the defendant but inaccessible to the plaintiff.

For example, a transfer is not constructively fraudulent if it is made for reasonably equivalent value. A post-confirmation trust may be a mere assignee of constructive fraud claims, without detailed knowledge of the debtor's business. It cannot evaluate the value given to the debtor without a great deal of detailed — and expensive — analysis. As for a preference, the post-confirmation trust may be merely running a 90-day check-register analysis believing that payments are within the appropriate time period, but it might not appreciate the complete historical relationship between the company and vendor. The vendor may have more facts that could change the initial surface analysis.

Given these constraints, mediation offers a useful first step in the adversary process. It is a platform for the parties to clarify and discuss their arguments, plus share with each other relevant facts in a less formal and less costly environment. It is also a forum to have a third party weigh in on the merits of the respective arguments and perhaps shed some light on strengths and weaknesses.

Further, it is often inefficient to litigate avoidance actions when a collectability against a defendant is at issue. Under the cloak of confidentiality in mediation, parties may address the practicalities of collection in a way that will not become public if the dispute goes to court. For example, financial disclosures could occur up front. This allows the trust (or plaintiff) to conduct a cost-benefit analysis of pursuing claims to judgment vs. settling out early to avoid the time and costs of obtaining a potentially worthless judgment.

Beneficial Mediation Processes

Successful mediations (ones that produce settlements or meaningfully narrow the issues) are not accidents. Proper processes increase the likelihood

1 Leslie A. Berkoff, Candice L. Kline & Turner N. Falk, "The Use of Mediation in Large Chapter 11 Cases: Useful, Voluntary and Mandatory (Part I)," XLII *ABI Journal* 8, 20-21, 52-53, August 2023, *available at* abi.org/abi-journal.

of a successful mediation, meaning how parties conduct them; the forum, the written statements and other processes all matter.

While remote mediation by Zoom is more common than ever, mediations are more likely to succeed if held in person. In-person mediation lowers the barriers, encourages real, practical communication among parties, and ensures that each party experiences the efficiency of mediation and appreciates the much-higher costs of litigation.

Using Zoom where the issues are discrete and focused — while keeping costs low and providing a quick process from a scheduling perspective — might still help parties expeditiously reach a settlement. Communication seems harder during remote mediations. A good mediator (and good advocates) recognize that the interpersonal connections made during the process are a reason why mediation successfully resolves disputes. The issue is how to best replicate the in-person experience in a remote mediation.

The ability to communicate across the proverbial table and connect is what leads to success and seems less obtainable via Zoom. At times, the ability to "reach" the client diminishes when not everyone is in the room together, even in a private caucus, putting aside the benefits of using a joint session effectively. When people are sitting privately in their own respective offices (formal or informal), they become distracted, intentionally or otherwise. They hop on and off other matters, and their focus is not fully on the matter at hand. When everyone is sitting in a conference room and left to discuss the case in between sessions, even if participants deviate at times to address other matters, their focus is still on the dispute at hand. Even the best mediator cannot focus attention as well when participants are not literally "all together."

Mediations almost always involve the submission of a mediation statement by each party. These statements may be for the mediator's eyes only, or may be accessible to all parties, depending on the agreed-upon mediation process. Attorneys often approach the mediation statement as if it was a court pleading. Better viewed, it is completely different and serves a different purpose.

Mediation statements should do more than merely repeat legal arguments and case law. They should address the practical issues in the case, with a realistic eye toward resolving and addressing the other side's concerns. They should be settlement-focused, analyzing and recognizing strengths, weaknesses and risks. Have parties make their statements available to all parties, with a supplemental statement for the mediator only, in which the party frankly addresses items like collectability, insurance coverage or a client's intransigence that will aid the mediator in facilitating a settlement.

The more honest a party is in its confidential statement to the mediator, the more effective a mediator can be in crafting a trajectory or path to resolve a matter. Discovering halfway through a mediation a key piece of information that changes the course of a negotiation could undermine the trust of the other side, and could compel the mediator to retract from a settlement path that they had been positioning for the parties.

When a large case generates numerous concurrent avoidance actions, many practitioners implement streamlining procedures for the mediation, settlement and discovery process. Among these useful procedures, a pre-mediation stay of discovery may help keep costs down while the parties exchange informal relevant materials through mediation. Likewise, a simple notice procedure for settlements minimizes the time and expense of Bankruptcy Rule 9019 settlement approval in cases with many small-dollar avoidance actions.

In the bankruptcy of Hahnemann University Hospital in Philadelphia, the bankruptcy court authorized streamlined mediation and adversary procedures for the simplified resolution of a mass of preference claims.[2] The debtor named four mediators who would be splitting up the nearly 100 avoidance adversaries. Defendants were able to select from among these four mediators for an automatic referral prior to any discovery. The procedures extended the time to file a response to the complaint, waived the pretrial and scheduling conference requirements, and stayed discovery until the mediation's conclusion. Participants reported that it was successful; between the entry of the procedures order in September 2021 and September 2023, all but two of these adversaries were resolved by settlement.

Confidentiality is key to a successful mediation, and the major large-case jurisdictions have already implemented strong confidentiality protections via mandatory procedures or local rules. However, if the parties have other concerns about specific information being exchanged, it is common for them to make requests to enter into supplemental confidentiality agreements regarding certain information being exchanged. As noted in previous articles written on this topic, all parties should consider the potential limitations on confidentiality.[3]

Timing of Mediation

Mediation may occur at many stages of the bankruptcy process depending on when the adversary case is filed and the issues in dispute. Where there is a need to define classes or rights of creditors, early-stage mediation is often extremely use-

Leslie Berkoff is a partner with Moritt Hock & Hamroff LLP in New York and chairs the firm's Dispute Resolution Practice Group. Candice Kline is a partner with Saul Ewing LLP in Chicago, and Turner Falk is an associate in the firm's Philadelphia office.

2 Order Establishing Streamlined Procedures Governing Adversary Proceedings Brought by Debtors Pursuant to Sections 502, 547, 548 and 550 of the Bankruptcy Code, *In re Center City Healthcare LLC d/b/a Hahnemann Univ. Hosp., et al.*, Case No. 19-11466 (MFW) (Bankr. D. Del.), Docket No. 2850.

3 Leslie A. Berkoff, "Is Your Dispute Resolution Process Truly Confidential?," *New York Law Journal* (Aug. 7, 2023); Leslie A. Berkoff & John G. Loughnane, "Limitations on Confidentiality," XLI *ABI Journal* 9, 26-27, 47, September 2022, *available at* abi.org/abi-journal.

ful.[4] Further, mediation is used to resolve confirmation issues to avoid protracted confirmation hearings or address side issues that could hang up or delay confirmation. For example, in *Garret Motion Inc*., the debtor, the committees and various other parties were negotiating the terms of a reorganization plan and reached an impasse. The debtor then asked the court to order the parties to mediation. The court agreed and issued an order outlining multiple issues that would be covered by a mediation process.[5] As another example, to bring some level of consensus to the confirmation process in *San Bernardino*, Hon. **Meredith Jury** ordered city officials into mediation with one of the few creditors still challenging the city's bankruptcy plan.[6]

Mediation was intended to reach consent to avoid a confirmation cramdown fight, because in the end, those fights often leave nothing for the victor. If mediation occurs later in the case — after confirmation or creation of a liquidating trust — the mediation dynamic is often very practical. The debtor is already liquidated or reorganized and has no pride or stake in the outcome aside from estate maximization. In this context, the plaintiff's main concern is money, since the outcome cannot impact any ongoing aspect of the reorganization.

Why Parties Mediate

In prior decades, referral to mediation happened on a case-by-case basis. As time has gone by, several bankruptcy jurisdictions have adopted local rules governing mediation. Most large cases often include mediation protocols with the commencement of large adversary proceedings. Today, it is almost routine to consider referring not just avoidance actions to mediation (either in large or small cases) but for other types of adversary proceedings, as well outside of traditional avoidance actions.

The authors have represented parties in large chapter 11 cases where the presiding judge has "strongly suggested" that a potential adversary action should be mediated, even where local rules do not otherwise require it. It is always a good tactical move to take the judge up on such a "suggestion." It may be that the suggestion is a way of telegraphing that the matter should be resolved either because there could be a delay in deciding it, the cost of trying it is disproportionate to the dispute itself, or the result of a decision will be truly unpleasant for one side.

A mediation referral is straightforward when all parties agree. In situations where one party affirmatively seeks mediation, the party generally has a good reason to do so. If representing the opposing side, counsel should seek to understand why their opponent wants to mediate. Do they want to keep costs down, streamline discovery or keep vital case information out of public filings? The rationale for seeking mediation could be key to obtaining a quick and satisfactory settlement. It is also important to recognize that suggesting mediation is not a sign of weakness, but rather a practical recognition of the economics of a case for all concerned.

Who Are Mediators?

By local rule or procedure, many courts have a panel of pre-approved mediators, many of whom are insolvency professionals highly knowledgeable about the intricacies of avoidance actions. It is important to consider using bankruptcy practitioners in cases involving traditional bankruptcy constructs, or even general claims within the bankruptcy context. Understanding how a liquidated claim fits within a bankruptcy scheme and the Bankruptcy Code is often integral to properly analyzing the strengths and weaknesses of the claim.

In cases involving unique or highly technical issues, it might be useful for the parties to agree to someone outside these panels to mediate, or even to consider co-mediation, so issues may fold into the bankruptcy structure. A specialist could give an assessment of strength based on deep industry knowledge in factually complex cases, such as those involving oil and gas, intellectual property, software and coding, or highly regulated industries. Finally, using the services of another bankruptcy judge to mediate a dispute may offer special expertise or gravitas; at times, such an appointment may be necessary to bring warring parties to the table if egos are such that only a current or former judge's view would count.

If Mediation Is Good, Why Oppose It?

Despite its benefits, parties sometimes oppose mediation. One concern is the cost associated with the mediation process akin to a "tax" — especially where mediation is mandatory. However, you get out of mediation what you put into it, and if properly approached, even unsuccessful mediations usually provide a benefit to the parties by identifying key facts, allowing the parties to better understand arguments and streamlining key issues.

When the parties desire a court hearing or trial, mandatory mediation and any public-position statements that merely repeat legal arguments may do little more than function as a kind of preliminary dispositive-motion procedure. Failure of the mediation then leads to the filing of an actual dispositive motion, and the mediation costs appear to be sunk. Although a valid quibble with mandatory mediation, one or both parties might be to blame for incorrectly approaching the mediation opportunity. Conscientious mediation procedures might aid the parties by placing pure legal argument on the back burner to focus on meaningful settlement discussions. A good mediator could help drive those discussions — if both parties cooperate and actively participate.

Some parties may genuinely prefer to litigate their dispute without mediation. Opposition to mediation can arise at any time, including during the appeals stage, when parties have hardened in their positions and desire judicial review. The authors have successfully used a staff mediation program at the circuit level, even when experiencing all of the usual headwinds to a global settlement, including a desire to win the appeal.

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4 *See* Debtors' Motion for Entry of an Order (I) Appointing a Judicial Mediator, (II) Referring Certain Matters to Mandatory Mediation, and (III) Granting Related Relief, *In re Boy Scouts of Am. and Delaware BSA LLC*, Case No. 20-10343 (LSS) (Bankr. D. Del.), Docket No. 17. These mediation procedures set up a dialog whereby the tens of thousands of abuse claimants supported the plan with more than 73 percent accepting. *See id.* at Docket No. 8141.

5 Order Establishing Terms for Plan Mediation, *In re Garrett Motion Inc., et al*., Case No. 20-12212 (MEW) (Bankr. S.D.N.Y.), Docket No. 954.

6 Document Indicating Case Is Being Sent to Mediation, *In re City of San Bernardino, California*, Case No. 12-28006 (MAJ) (Bankr. C.D. Cal.), Docket No. 2060. As an aside, the authors, in less well-known cases, have served as mediators or participated in mediations involving competing plans, warring factions or lingering disputes between secured creditors and unsecured creditors.

Litigants often hold strong principles and believe that pursuing litigation is necessary to uphold those principles. They may refuse to engage in settlement discussions based on the principle that it would compromise their position and bolster their opponent's claims. The belief that justice is only achieved through a full trial, regardless of the cost, is deeply ingrained in American culture. However, litigants often fail to recognize the financial and emotional costs associated with protracted litigation, or the "price of principle."[7]

In preparing this article, the authors asked a number of mediators and attorneys who have participated in major mediations whether an investment in principles in one case has ever borne fruit in another case. The uniform answer to this informal survey was clear: No avoidance plaintiff had ever meaningfully shied away from a potential defendant because of a strong stand in an earlier case. Instead, other factors, such as the choice of defendant's counsel, may influence the trajectory of a mediation.

Conclusion

Mediation in large chapter 11 cases offers a valuable alternative to lengthy and costly litigation. It addresses substantive legal issues, promotes efficient discovery and provides a platform for parties to express their principles. It also offers confidentiality compared to an open-court process. While opposition to mediation exists due to concerns about costs, transparency and a desire for parties to have their day in court, the price of principle should be carefully evaluated.

Mediation, with the aid of skilled mediators, often helps parties navigate the complexities of their disputes, manage their expectations and explore mutually beneficial resolutions. By considering costs, risks and business-judgment aspects through a mediation process, parties might achieve better-informed decisions that serve their best interests and a fair and efficient resolution. abi

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7 Leslie A. Berkoff & Connor Bifferato, "The Price of Principle," XLI *ABI Journal* 6, 18-19, 60-61, June 2022, *available at* abi.org/abi-journal.