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Mediating With a Litigation Committee Or Trust

Bankruptcy cases offer key differences.

BIGSTOCK

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While mediation is used in many forums, mediation in the bankruptcy context at times offers some very unique and key distinctions. One key difference is that the party often acting as the plaintiff in the adversary proceeding or contested matter[1] is not necessarily the business owner but rather a litigation committee[2] or trustee who is running a court ordered process long after the debtor has failed.[3] Thus, the procedural context is very different than other traditional cases where both parties involved in the mediation were also involved in the original "dispute" and are at the table resolving *their* own personal issues and competing claims. In these cases, the plaintiff has no historical knowledge of the facts, or underlying business arrangements that relate to the dispute at hand. Moreover, it is entirely possible that the key employees or other parties with knowledge of the history and facts are long since gone—having lost their jobs months or years prior during the failed restructuring of the corporate operations or having left for greener pastures when things turned rocky or uncertain. Thus, the plaintiff has to learn all of the key facts at a time when there may be no one with first-hand knowledge to educate them.

The question is—does the process still work? Can you successfully mediate with a new and unfamiliar party at the table? The answer, this author believes, is yes and by experience, it works quite well. The absence of a party with historical knowledge does not preclude the usefulness or success rate for the mediation process. Rather, the replacement at the table with a party whose primary obligation is to act as a fiduciary to maximize assets, minimize and justify expenses, and ensure a reasonable return for creditors may in fact allow for a more expeditious resolution of the case. In my experience, this new plaintiff can oftentimes survey the facts with more benign objectivity and can call upon knowledge gleaned from other similar businesses where they might have served in a similar capacity in the past. Thus, these plaintiffs are open to being educated on the specific business facts, unique to the debtor's business currently at play. Moreover, they can, without emotional or historical baggage, analyze the pros and cons of the litigation risks that are before them and decide how to proceed.

Recognizing the usefulness of the mediation process in balancing costs and resolving disputes has led bankruptcy courts to champion this process in the business context. Although the Federal Rules of Bankruptcy Procedures are silent about the ability to use mediation in the bankruptcy forum, 51 bankruptcy courts have opted to create court rules that authorize the use of mediation; other courts have used mediation on an ad hoc basis.[4]

Bankruptcy courts derive the power to implement mediation from both statutory and rule based authority. Specifically, Congress passed the Authorization of Alternative Dispute Resolution in 1998 (Public Law 105-315-Oct. 30, 1998), which provides for the use of alternative dispute resolution in bankruptcy.[5] Over time, many bankruptcy courts have established formal mediation programs and procedures and implemented local rules to govern the process.[6] Moreover, most courts have now established mediation panels comprised of pre-approved (and at times

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pre-vetted) panel mediators who can be called upon to serve in a case. This is simply not a new process for the bankruptcy courts.

In recent years, mediation has been especially effective in the context of "mega-bankruptcy" cases.[7] Examples of these cases include both the Enron and the Adelphia Communications bankruptcy cases, each of which eventually found their way to judicial mediators.[8] In both cases, multiple disputes within the bankruptcies cases were referred to mediation, including claims objections, efforts to recover assets, and declaratory judgment actions or specific discrete factual and legal issues.[9]

At their core, bankruptcy courts are courts of "dispute resolution where qualified debtors reapportion their debt allocation. Efficiency is the priority. Within this statutory framework, judges, trustees, and credit counselors serve dispute resolution roles identifying the creditors that are to be involved, facilitating the development of the plan and deciding on how the debt allocation will proceed."[10] Part of the impetus in all of these cases to using mediation is the benefit of reducing costs, as bankruptcy litigation costs for the debtor (or estate representative) or litigation committee are paid from property of the estate. Funds paid for litigation diminish and deplete creditor recoveries. Thus, plaintiffs bear the responsibility of carrying out their fiduciary duty to creditors and acting in a cost effective manner that must at the end of the day serve as a guiding force.[11] As a general rule, trustees (including liquidating trustees) are guided by their primary objective to maximize recovery for the estate or specific classes of creditors. Their decisions are governed by the business judgment rule, which holds that the trustee's decisions and actions are entitled to respect and deference, if the trustee can articulate a sound business reason for the action taken.[12]

While many defendants often express concern over the use of a "litigation appointed plaintiff," in the process, more often than not the clinical and dispassionate approach applied by this new party when balanced by need to justify fees more than tempers any lack of historical knowledge or personal history. Rather, plaintiffs feel constrained to justify any actions they take more keenly than other traditional plaintiffs do.[13] So too, a creditor's committee has a fiduciary obligation to represent the interests of all unsecured creditors.[14]

Mediation is a delicate process that works best when parties are committed to the resolution and keep their eye on the end goal of achieving a reasonable result that balances litigation risks and concerns. The insertion of a new party into the factual dispute between business entities that have a history as to which this new party may have no first hand familiarity does not adversely affect that dynamic.

Given the considerations that one must draw upon as guidelines in resolving matters in mediation, i.e., costs, risks and closure, are the same kinds of concerns that underpin the fiduciary obligations held by the plaintiff in these matters, the consistency of these concerns only serves to facilitate a reasonable and expeditious result. Overall, defendants should appreciate that an increased level of objectivity is brought to bear on the process and recognize that the need to unemotionally balance these concerns may allow for a more expeditious and efficient result that benefits them in the end.

1. Adversary proceedings are litigations brought within the context of a bankruptcy case and involve discrete issues that are being litigated in the bankruptcy forum, whereas contested matters arise when affirmative relief sought by motion practice is opposed. In either context, the rules of discovery come into play and mediation is often utilized to resolve the issues. See Rules 7001 and 9014 of the Federal Rules of Bankruptcy Procedure.

2. See *In re Commodore Int'l*, 262 F.3d 96, 99 (2d Cir. 2001) (recognizing the ability for creditor's committees to initiate adversary proceedings to pursue litigation in the name of the debtor); see also *In re STN Enters.*, 779 F.2d 901, 904 (2d. Cir. 1985).

3. Alternatively, it may be that the debtor is simply out of the picture having divested itself of such claims for the benefit of the unsecured creditor body under a plan or by other agreement. See Order Granting Motion of BGI Creditors' Liquidating Trust and the Liquidating Trustee to Establish Procedures Governing Adversary Proceedings Brought Pursuant to Sections 547 and 550 of the Bankruptcy Code, *In re BGI, f/k/a Borders Group*, Case No. 11-10614, Doc. No. 2922, and Order Establishing Procedures Governing Adversary Procedures Brought Pursuant to Sections 547 and 550 of the Bankruptcy Code, *In re Oldco M Corporation (f/k/a Metaldyne Corporation)*, Case No. 09-13412, Doc. No. 1726.

4. Elayne E. Greenberg, "ADR Meets Bankruptcy: Cross-Purposes or Cross-Pollination?: We Can Work It Out: Entertaining a Dispute Resolution System Design for Bankruptcy Court," 17 Am. Bankr. Inst. L. Rev. 545, 547 (2009) (noting that "[u]nbeknownst to many, bankruptcy courts have been using mediation as part of the case management of bankruptcy cases since 1986 when the Southern District of California established the first mediation program").

5. See 28 U.S.C. §§651-658, 651(b) (2014) (identifying current statutory citation).

6. Prior to the implementation of formal local rules, many bankruptcy judges relied on §105 of the Bankruptcy Code to facilitate the mediation process.

7. See Hon. Cecelia G. Morris & Cheryl J. Lee, "From Behind the Bench: Toward an Efficient Mediation Model—Evaluative Mediation in Bankruptcy," 4 Norton Bankr. L. Advisor 2, 6 (2007).

8. So too, have many other bankruptcy cases utilized this, entering orders providing for Proposed Procedures in cases where a debtor, creditors' committee or trustee anticipates filing a large number of avoidance actions. See, e.g., *In re Oldco M. (f/k/a Metaldyne)*, Case No. 09-13412 (MG) (Bankr. S.D.N.Y.) (Docket No. 1726); *In re Lehman Brothers*, Case No. 08-01420 (JMP) (Bankr. S.D.N.Y.) (Docket No. 2894); *In re Creative Group*, Case No. 08-10975 (RDD) (Bankr. S.D.N.Y.) (Docket No. 421); *In re Bernard L. Madoff*, Adversary Case No. 08-01789 (BRL) (Bankr. S.D.N.Y.) (Docket No. 3141).

9. See also Greenberg, supra note 4. Mediation has also proven to be a significant tool in the Detroit bankruptcy case. In fact, it has been recognized that, absent the use of mediation, in this case the funds and resources were simply not there to efficiently resolve the issues. "What has transpired is a delicate balancing act in bankruptcy court, where the public's right to know how public money is being handled is being weighed against the rights of creditors and debtors to resolved their disputes in private." See Tresa Baldas, Matt Helms & Alisa Priddle, "How Mediation has Put Detroit Bankruptcy on the Road to Resolution," Detroit Free Press, Feb. 20, 2014, http://www.freep.com/article/20140202/NEWS01/302020063/Orr-Snyder-Rosen-Detroi-bankruptcy. As lead mediator, Chief Judge Gerald E. Rosen oversaw several contentious restructuring talks between the city and its creditors, brokered the rescue fund to boost pensions and shielded artwork from being sold. Id.

10. Greenberg, supra note 4, at 547.

11. "[A] bankruptcy or reorganization trustee is a fiduciary of each creditor … . As such, he has a duty to treat all creditors fairly and to exercise that measure of case and diligence that an ordinarily prudent person under similar circumstances would exercise." David P. Primack, Note: "Confusion and Solution: Chapter 11 Bankruptcy Trustee's Standard of Care for Personal Liability," 43 Wm. & Mary L. Rev. 1297, 1309 (2002) (citing *Hall v. Perry (In re Cochise College Park)*, 703 F.2d 1339, 1357 (9th Cir. 1983)). For a lengthy discussion on the standard of care to be applied to actions of trustees, see id. ("The first and only Supreme Court case to address the issue of the standard of case for a reorganization trustee is *Mosser v. Darrow*."). In *Mosser v. Darrow*, the Supreme Court recognized that it needed to be proactive in protecting bankruptcy trustees so they were not hindered in making business judgments by others that these decisions could later be "open to serious criticism by obstreperous creditors aided by hindsight." *Mosser v. Darrow*, 341 U.S. 267, 273-74 (1951).

12. See *In re Diplomat Const.*, 481 B.R. 215, 220-21 (Bankr. N.D. Ga. 2012); see also *Comm. of Equity Security Holders v. Lionel (In re Lionel)*, 722 F.2d 1063, 1070 (2d Cir. 1983); *In re Thomson McKinnon Secs.*, 120 B.R. 301, 307 (Bankr. S.D.N.Y. 1990).

13. "The benchmark for determining the propriety of a bankruptcy settlement is whether the settlement is in the best interests of the estate." *In re Energy Coop.*, 886 F.2d 921, 927 (7th Cir. 1989); see also *Martin v. Kane (A & C Properties)*, 784 F.2d 1377, 1380 (9th Cir. 1986), cert. den. sub nom, *Martin v. Robinson*, 479 U.S. 854 (1986). The seminal case in this area is *Drexel v. Loomis*, which highlighted the paramount interests of the creditors and a proper deference to their reasonable views. *Drexel v. Loomis*, 35 F.2d 800, 806 (8th Cir. 1929). It is well established that compromises are favored in bankruptcy. See 9 Collier on Bankruptcy ¶ 9019.03 (15th ed. 2008). As the Supreme Court noted in *TMT Trailer*, "[i]n administering reorganization proceedings in an economical and practical manner, it will often be wise to arrange the settlement of claims to which there are substantial and reasonable doubts." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 424 (1967).

14. See, e.g., *In re Bohack*, 607 F.2d 258, 262 n.4 (2d Cir. 1979) (confirming that a "committee owes a fiduciary duty to the creditors, and must guide its actions so as to safeguard as much as possible the rights of minority as well as majority creditors" (citing *Woods v. City Nat'l Bank & Trust*, 312 U.S. 262, 268-69 (1941))); *In re Caldor*, 193 B.R. 165, 181 (Bankr. S.D.N.Y. 1996); *In re Ionosphere Clubs*, 101 B.R. 844, 855 (Bankr. S.D.N.Y. 1989); *In re McLean Indus.*, 70 B.R. 852, 862 (Bankr. S.D.N.Y. 1987).