

Mediation and insolvency

In the light of the current economic downturn it was timely that on the agenda of the 16th Annual Global Insolvency and Restructuring Conference held in Hamburg in May 2010 was a session entitled "*Mediation ADR and Insolvency*".

The conference was organised by the International Bar Association's (IBA) section on Insolvency, Restructuring and Creditors' Rights and supported by the IBA European Regional Forum. The conference was entitled, "*Cleaning up the mess: restructuring and insolvency approaches worldwide*".

CEDR Solve panel mediators, Birgit Sambeth Glasner^[1] (based in Geneva) and Nick Pearson^[2] (London) [Nick is also a CEDR Solve Direct Mediator] were on the panel leading this topic.

Both of them have acted in a number of insolvency related mediations. Typically these will be disputes between the insolvent entity (in liquidation, bankruptcy or administration) and a third party or parties, not that dissimilar from a dispute outside the context of insolvency. Differences may arise though if insolvency related remedies are sought—eg, misfeasance claims against directors, preference claims, claims to set aside transfers at undervalue, etc, and steps may have to be taken to ensure appropriate authority to settle is provided by the court or creditors' committee.

In addition it is often the case that insolvency will bring the parties to mediation earlier in the dispute than might otherwise be the case, given what may be limited costs available in the insolvent party and the need to bring matters to a speedy resolution when there is no prospect of ongoing business relationships.

The Hamburg seminar looked at mediation in insolvency matters from various different perspectives and jurisdictions. Current details were provided about the recent Mediation Orders made in the context of the US Lehman bankruptcy. Recent additions to the UNCITRAL's Cross Border Insolvency Rules concerning use of mediation were discussed, as well as the possible use of mediation in voluntary restructuring proceedings or schemes of arrangement.

With thanks to Birgit and Barbra Parlin [see below], Nick reports as follows.

Scope of mediation in the insolvency field

In many cases, as indicated above, mediation is ideally suited to insolvency cases where, for example claims made need to be settled quickly and where creditors, having already lost money, want to find ways of reaching resolutions cost effectively.

The arrival of a third party professional administrator into the insolvent entity does bring to the problem a new set of eyes and an independence which is not necessarily there pre insolvency. Most insolvency practitioners and office holders (eg, liquidators or administrators) are very experienced negotiators and well as able to see and separate the trees in the wood, but, they are not all trained as mediators and can find the use of an independent mediator of value. However much they may be independent of the insolvent company they represent, they can still be seen to be fighting its cause and inevitably perhaps drawn to one side only of the dispute.

There does not seem to be any type of dispute found within the insolvency field which is not suitable to be resolved through mediation - even fraud claims are successfully mediated - although sometimes you have to allow some time to elapse after the fraud for feelings to settle.

The only type of dispute that would not be suitable for possible resolution through mediation would be one where the office holder needs a ruling from the court so that a precedent is set which will enable other similar or identical case to be resolved.

In the UK the courts have made it clear that they support the use of mediation in appropriate cases. The Chancery Court Guide 2009, which sets out rules by which insolvency cases before it are managed, provides, at Chapter 17, for the general use of alternative dispute resolution (ADR), including, in particular, mediation, and makes it clear that it will refer cases to mediation where appropriate and that the parties' lawyers should consider the use of ADR in all cases.

In addition to these types of claim there was considerable discussion at the seminar as to the role experienced mediators might play in non-litigation situations where problems arise. For example, to help overcome logjams or negotiating hurdles in the context, not of litigation, but in restructuring problems. It was recognised that insolvency administrators had considerable experience in this area but negotiating corporate solutions with different constituencies - eg, shareholders, directors, different classes and categories of creditors, financiers etc - can throw up complex problems and situations upon which independent and objective expertise through the use of mediation could be useful. Although no examples were given as to situations where mediators have been involved, problem areas where their skills might have added value were raised.

Use of ADR /Mediation in the UK in Schemes of Arrangement or Company Voluntary Arrangements

Under the prevailing companies and insolvency legislation Schemes or Arrangements are often used to resolve and compromise claims attaching to an insolvent entity. Schemes or Arrangements can be adopted under relevant legislation if approved by 75% of the creditors by value - see Companies Act 2006 Part 26 and Insolvency Act 1986 Part 1. Such Schemes or Arrangements often (usually) include within their terms (to which creditors will subscribe) Dispute Resolution Procedures. If there are disputes between an insolvent company and its creditors, as there will often be, these procedures will normally provide that they are dealt with - if not resolved by negotiation - by alternative processes other than going to court.

For example the supervisor of the Scheme may be empowered to resolve the claims, and, if that fails, the matter resolved by an appointed valuer (often accountant) or arbitrator(s).

In the administration of Lehman Brothers International Europe Limited which is presently being conducted in the UK, the administrators have recently entered into a contractual arrangement with a large group of creditors where there are uncertainties and disputes as to the ownership of assets -claims are made that some assets are held in trust for the benefit of third parties and thus outside the scope of the administration. To resolve these problems swiftly and cost effectively, a creditors' Claim Resolution Agreement has been entered into through which, in effect, these claims are compromised. Where matters remain in dispute the parties have agreed that these may, as an alternative to the court, be resolved by a Valuation Expert or by an Adjudicator. Although no mention is made of mediation in this context there remains no reason, of course, why this cannot occur if it might, as it may, provide a way of reaching a solution acceptable to the parties.

In the context of court claims the Chancery Court Guide mentioned above remains highly relevant.

Use of mediation within continental Europe and UNCITRAL position

Although mediation is not generally yet as advanced in the civil law countries as it is in the UK, increasingly it is being used in insolvency matters.

The French and Greek insolvency regimes specifically provide for the use of "*conciliation*" whereby conciliators have a role in assisting a company in financial difficulties to work out a plan with its creditors. They deploy many of a mediator's skills and also have an obligation of confidentiality.

The Greek conciliation procedure provides a debtor which foresees upcoming liquidity problems and potential default in its payments with the opportunity to seek an agreement with the majority of its creditors to avoid financial hardship or default. The debtor files a petition with the court which then appoints a mediator to promote an agreement between the applicant and at least those entities which hold the majority of its debts. The aim is to reverse the debtor's financial hardship through debt reduction, refinancing, securitization or any other measure deemed or agreed necessary. The judge can impose, as an interim measure, a judicial moratorium on all enforcement actions against the debtor while the conciliation process is ongoing.

Similarly, France has two amicable proceedings for enterprises facing difficulties: the "*procedure de conciliation*"^[3] and the "*mandataire ad hoc*"^[4], appointed by the court. Both proceedings have the purpose to allow amicable and confidential negotiation of the debt issues. Conciliation lasts usually 4 months, whereas the "*mandataire ad hoc*" may have a longer lifetime. The CEO of the company continues to fulfil all the duties of his office. The conciliator assists him in seeking an arrangement with the creditors and negotiating it. An order to stay enforcement measures against the company up to two years might be ordered by the court. It appears that

in the majority of the cases where one or other of these processes has been used, the indebted companies have been rescued and showed a lasting recovery of business.

In Belgium, since April 2009, a new law^[5] has been enacted providing for a mediator to be appointed by the court at the request of the debtor, with the purpose of facilitating the reorganisation of the company. The proceedings are very informal in order to allow a maximum of flexibility. The mediator is an agent of justice (“un mandataire de justice”) and his intervention ends when either the debtor or the mediator so requests. The intervention of the insolvency mediator is identical to a usual mediation process and applies the same principles.

The German system has no formal process through which mediation might be used in its insolvency regime but there was no dissent at the conference that potential value could be achieved wherever and whenever the local processes permitted its use. An important concern, of course was to work within what in some jurisdictions were seen to be somewhat rigid insolvency laws.

The same applies to Switzerland, even though the introduction of mediation into its new federal civil procedural law, starting January 2011, allows the use of ADR proceedings in other fields where they are of utmost relevance. Furthermore, private mediations can be performed any time between the liquidator and creditors, respectively debtors of the estate, notably in D&O liability matters.

The UN Commission on International Trade Law (UNCITRAL) was established by the UN General Assembly in 1966 to “further the progressive harmonisation and unification of the law of international trade”. “International Trade Law” includes insolvency law. Amongst its major insolvency law initiatives is the 1997 UNCITRAL Model Law on Cross Border Insolvency.

In 2009 it produced the UNCITRAL Practice Guide on Cross Border Insolvency Cooperation. Amongst many other matters this Guide has recognised the value of mediation in the international insolvency area.

For example, in the context of encouraging judicial co- operation in cross border insolvencies and allocating responsibilities through the use of insolvency agreements between different jurisdictions, the Guide provides, at paragraph 72, for consideration to be given to the resolution of disputes through mediation.

Communications between insolvency courts in different jurisdictions is encouraged. At paragraph 149 reference is made to a case concerning litigation against a debtor in the USA and insolvency proceedings in the Netherlands Antilles where direct communication resulted in an order of the US State Court, with the concurrence of the Netherlands Antilles Court, directing mediation and the appointment of a mediator.^[6]

It was noted at the seminar, however, that such direct interaction is not always feasible from many European courts.

Note also within Annex 1 of the Guide (where various case summaries are given) the following,

“21. *Manhatinv (2000)**

The insolvency agreement in Manhattan Investment Fund Limited (Manhatinv), a case involving the United States and the British Virgin Islands, listed a number of objectives including coordinating the identification, collection and distribution of the debtor’s assets to maximize their value for the benefit of creditors and the sharing of information (including certain privileged communications) between the respective insolvency representatives to minimize costs and to avoid duplication of effort. The insolvency agreement included detailed provisions on cooperation between the insolvency representatives, who were to develop a workplan addressing material steps to be taken. It also included a provision for mediation of disputes between the insolvency representatives arising under the agreement.”

“ = United States Bankruptcy Court for the Southern District of New York, Case No. 00-10922 (April 2000), the High Court of Justice of the British Virgin Islands (19 April 2000) and the Supreme Court of Bermuda, Case No. 2000/37 (April 2000).”*

Uncitral’s Working Group 5 which reviews insolvency issues continues to keep these matters under review and to seek to adopt procedures which recognize the benefits of ADR/mediation.

Insights from the USA—Lehman Brothers Mediation Orders

Barbara Parlin, a partner in the US firm, Holland and Knight LLP^[7], gave a helpful summary of the US position as regards use of mediation and ADR generally - in her jurisdiction and an update on mediation in the context of the Lehman bankruptcy.

ADR in all its many and evolving forms is a key feature of the US legal system. Mediation is a tried and tested practice. It is regularly used in the context of seeking to sort out disputes in the insolvency arena. Most US bankruptcy courts have mediation programmes available to help parties. Mediation may be and often is directed by the court—as in usual litigation processes.

Disputes arising out of the negotiation and implementation of a restructuring plan are not typically resolved through mediation but more often by the interested parties and perhaps with the guidance/assistance of the allocated judge.

In a number of bankruptcies involving multiple claims the bankruptcy court has imposed orders requiring mediation to take place. As a matter of practice the Delaware Bankruptcy Courts—which see high number of US bankruptcies - require mediation in every avoidance action - e.g. claims to set aside a payment made prior to bankruptcy on an allegedly preferential basis. Such orders are made to help the court control its docket and to help reduce time and cost involved in the dispute process.

In September 2008 Lehman Brothers Holdings filed for its bankruptcy, generating thousands of cases and disputes by and against the company and its subsidiaries and associates.

The Bankruptcy Court has entered several procedures orders in this bankruptcy aimed at streamlining and controlling the outstanding claims and counterclaims. In particular the Court has entered orders which require participation in ADR procedures both to resolve affirmative claims where Lehman is the claimant (mostly derivative transactions) and claims against the bankrupt estate. These ADR procedures apply at Lehman's discretion only - *i.e.* Lehman designates matters for ADR.

Some creditors and even some other Lehman debtors (in Europe) objected to these procedures as favoring the US Lehman Debtors, in part because they have access to the valuation documents submitted by creditors as part of the claims submission process while the creditors do not have access to corresponding information from the US Debtors. Typically, of course, in mediation the parties will often try to keep their claims figures to themselves as long as they can since, once given, negotiations can only move down from them.

Other parties have argued that the Lehman ADR and mediation processes should not replace the claims' resolution process provided for in the Bankruptcy Code or the parties' ISDA contracts.

Notwithstanding these objections, the Bankruptcy Court has made it clear that mediation is mandatory, and to enforce participation in ADR, the Court has issued a temporary litigation injunction (TLI) that expires only when the claim is settled, the parties agree to litigate or the Court enters an order lifting the injunction.

The Bankruptcy Court may also order sanctions if a party fails to participate in ADR procedures in good faith.

The first step is for Lehman to designate a matter for ADR procedures.

Once a matter is designated for ADR, the TLI applies, no discovery may be taken and no litigation occurs.

ADR procedures outline information to be exchanged, and a timeline of process, and provide for confidentiality of information exchanged.

If matters are not resolved after initial information exchange, parties proceed to mediation.

Failure to participate in ADR can result in sanctions, including an award of attorneys' fees, and/or entry of judgment against the other party.

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Participation in ADR and mediation does not waive a party's existing right to a jury trial, to arbitrate, or to an exclusive foreign forum to the extent such rights exist and the case does not settle.

Mediation is to occur in New York City, but, upon consent of parties, it may occur by telephone.

Lehman selects 4 possible mediators from a published list, and the counterparty is permitted to strike 3 out of 4 unless the parties otherwise agree to a non-listed mediator.

Lehman pays the mediator's fees and costs.

It can be seen that these procedures provide a sensible attempt to try to deal with a very unusual situation in a timely and efficient way. There is no reason in principle why, should similar circumstances exist, courts in other jurisdictions could not learn from these processes and adopt them, or relevant ideas from them, where appropriate, should their law and procedures allow for this.

Summary

It was clear from the seminar and discussions from the delegates who came from all over Europe and further afield that there was great interest in this topic and in the use of mediation, especially where opportunities could be developed to improve the speed and efficiency with which disputes in the insolvency world might be resolved.

Clients are increasingly attuned to what might be achieved and ideas developed in and generated in one jurisdiction quickly cross borders to others.

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[2] Nick recently retired as head of Baker & McKenzie's Global Dispute Resolution Group and now acts as a full time commercial mediator—nick@mangertonmanor.co.uk. Nick's [full CV](#) is available on the CEDR Solve website.

[3] Articles L. 611-2 à 611-15 of the Code of Commerce. Since July 2005

Conciliation procedure is available to any trading or craft business which experiences either legal, economic or financial difficulties, present or foreseen, and which is not in “*cessation de paiement*” (i.e. unable to meet its due and outstanding liabilities with its available assets) for more than 45 days.

[4] Articles L.611-3 and R.611-18 to R.611.20 of the Code du Commerce.

[5] Loi du 31 janvier 2009 relative à la continuité des entreprises : article 13.

[6] [See *Petition of Husang and DePaus, trustees of SunResorts, Ltd. N.V.*, Case No. 97-42811

(BRL) (Bankr. S.D.N.Y. 1999) and *SunResorts Ltd. N.V.*, Court of First Instance, Netherlands Antilles, Seat St. Maarten, 1997]

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