AMERICAN BANKRUPTCY INSTITUTE

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CONCURRENT SESSION

Hosted by the Bankruptcy Litigation and Mediation Committees

Breaking the Log Jam: The Trend Toward Pre-Plan Mediation of Case-Dispositive Disputes in Chapter 11

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DISCUSSION TOPICS FOR CASE DISPOSITIVE MEDIATION PANEL

(ABI SPRING MEETING, 2019)

1. Types of cases that may benefit from mediation to reach case dispositive results
    a. Mass tort cases
    b. Insider conflict cases
    c. Chapter 9 cases
    d. Any non-consensual/contested multi-party case
    e. Any case with a possible business solution, but where litigation will likely harm multiple constituencies
2. When should case dispositive mediation occur?
    a. Early
        i. Premature? What if there is a global consensus on the need for reorganization, e.g., in a regional hospital case?
        ii. Allow a critical "first-day" or initial dispute, e.g., a lift stay motion or a motion to dismiss, to be litigated so that all parties recognize the risks inherent in litigating?
    b. Pre-plan filing
        i. Non-solicitation concerns?
        ii. Opportunities for consensus on a plan support agreement
    c. Post-plan filing
        i. Opportunities to obtain support from impaired classes and ability to modify plans prior to solicitation
        ii. During solicitation period to avoid cost, delay, and risk of a contested confirmation hearing
        iii. Considerations of material modifications after solicitation and plan supplements

d. As a final, desperate attempt to salvage the case

3. Who decides on whether to appoint a mediator?

   a. Can/should the court compel/order mediation?

      i. Is mandatory mediation an oxymoron?

   b. On the request of the Debtor or any single party?

   c. Only upon the request of all parties?

   d. How to respond if a request for mediation is perceived as a "litigation tactic," i.e. one side is requesting it simply to delay a ruling or posture on an issue

4. Who should participate?

   a. All significant players

   b. Only those who are "in the money"?

   c. Only those who have the money, e.g., D&O insurer, bank, buyer

   d. Those with a blocking position

   e. Potential litigation defendants

5. What is the role of the mediator?

   a. Facilitative mediator

   b. Evaluative mediator

   c. Sitting judge

   d. Retired judge

   e. Non-judicial mediator

6. What is the best format for mediation?

   a. Joint setting

   b. Shuttle diplomacy

   c. Mixed

BANKRUPTCY COURT'S AUTHORITY TO MANDATE MEDIATION AND SCOPE OF GOOD FAITH PARTICIPATION

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> "*While the possibility that parties will fail to reach agreement remains ever present, the boon of settlement can be worth the risk."* In re Atlantic Pipe Corp., 304 F.3d 135, 145 (1st Cir. 2002).

Mandatory, or court-ordered, mediation is often criticized as an oxymoron because it is asserted that the very nature of a mediation requires the voluntary participation of the parties in a collaborative process. Critics often bristle at the idea of court-ordered mediation as a waste of time and resources, reflecting on the old adage that "you can lead a horse to water, but you can't make him drink." Yet, the use of court-ordered mediation is becoming increasingly common in bankruptcy cases. The trend of establishing mandatory mediation procedures is now relatively commonplace as part of an estate's preference litigation strategy; however, the use of mandatory mediation as part of pre-plan negotiations and other case dispositive issues has also increased in frequency. Given the increasing use of mediation, including mandatory mediation involving dispositive case matters, these materials will consider the extent and source of a bankruptcy court's authority to compel compulsory mediation. In addition, the materials will explore the scope of "good faith" participation in mandatory mediation and challenges to the bankruptcy court's jurisdiction to compel mediation.

1. A Bankruptcy Court's Power to Compel Mediation

Historically, the bankruptcy court's authority to compel parties to mediate was rooted in the court's inherent powers. Prior to 1998, courts compelling mediation often cited *Link v. Wabash*

[1] I would like to extend my sincerest gratitude to Timothy J. McKeon, associate at Mintz Levin Cohn Ferris Glovsky and Popeo, PC, for his terrific assistance in preparing these materials.

R. Co., 370 U.S. 626, 630 (1962), as recognizing courts' "inherent power" to control their docket and manage their own affairs. Other sources of authority included Bankruptcy Code section 105, and even the use of examiners under Bankruptcy Code sections 1104 and 1106 to facilitate plan negotiations.[2] In 1998, Congress enacted the Alternative Dispute Resolution Act (the "ADR Act"), which requires district courts to adopt rules for the "use of alternative dispute resolution processes in all civil actions, including adversary proceedings in bankruptcy . . . ."[3] Subsequent to the passage of the ADR Act, the strongest source of authority for mandatory mediation appears to be a court's local rules, to the extent they exist and include appropriate compulsory language. However, to the extent the scope of the proposed mediation falls outside of the court's local rules, bankruptcy courts continue to routinely exercise their authority to compel mediation through their inherent powers, as well as rely on specific sections in the Bankruptcy Code, the Federal Rules of Civil Procedure, and/or the Federal Rules of Bankruptcy Procedure. *See*, *e.g.*, *In re Chemtura Corp.*, Case No. 09-11233, Dkt. No. 5011 (Bankr. S.D.N.Y. Jan. 25, 2011), Transcript of Oral Ruling at 69:1-70:8; *see also In re Atlantic Pipe Corp.*, 304 F.3d 135, 142-45 (1st Cir. 2002).

a. ADR Act and Proliferation of Local Rules

The ADR Act provides that "each United States district court shall devise and implement its own alternative dispute resolution program . . . to encourage and promote the use of alternative dispute resolution in its district." 28 U.S.C. § 651(b). The ADR Act recognizes the use of compulsory mediation under 28 U.S.C. § 652, which provides that "any district court that elects to require the use of alternative dispute resolution in certain cases may do so only with respect to

[2] *See* Ralph R. Mabey et al., *Expanding the Reach of Alternative Dispute Resolution in Bankruptcy: The Legal and Practical Bases for the Use of Mediation and the Other Forms of ADR*, 46 S.C. L. Rev. 1259, 1313 (1995). *See also In re A.H. Robins Co*., 88 B.R. 742 (Bankr. E.D. Va. 1986) (examiner's authority included monitoring the progress of plan formulation and suggesting proposed elements of a plan).

[3] 28 U.S.C. § 651(b).

mediation, early neutral evaluation, and, if the parties consent, arbitration." 28 U.S.C. § 652 (emphasis added). In addition, the ADR Act requires that the alternative dispute resolution process involve a "neutral third party [that] participates to assist in the resolution of issues in controversy, through processes such as early neutral evaluation, mediation, minitrial and arbitration . . . ." 28 U.S.C. § 651(a). As part of the establishment of such an ADR process, the district courts are required to develop local rules to regulate the use and function of "alternative dispute resolution processes in all civil cases, including adversary proceedings in bankruptcy[.]" 28 U.S.C. § 651(b) (emphasis added).[4]

Subsequent to the passage of the ADR Act, local rules were enacted or were modified to provide for alternative dispute resolution processes. *See Chemtura*, Tr. at 70:9-13 (citing *Atlantic Pipe*, 304 F.3d at 140). Currently, 76 of 94 districts (80.85%) have adopted some type of local rule for mediation, while the remainder (18, or 19.15%) have not.[5]

By way of example, the following is a sampling of districts and the corresponding local rule(s) governing mediation:

District	**Rule(s)**
District of Delaware	Del. Bankr. L.R. 9019-2, 9019-3, 9019-5, 9019-6, 9019-7
Northern District of California	B.L.R. 9040-1 – 9050-1 (*Bankruptcy Dispute Resolution Program*)
Southern District of California	LBR, Appendix III (*Adoption of Mediation Program for Bankruptcy Cases and Adversary Proceedings*)
Northern District of Illinois	Local Bankruptcy Rule 9060-1 (two sentence rule)

[4] Some commentators have suggested that the utility of the ADR Act to compel mediation in a bankruptcy case may be in doubt or only apply in limited scenarios. In particular, the Administrative Office of the United States Courts has stated that the ADR Act "only applies to adversary proceedings in bankruptcy for which reference has been withdrawn, and which are being heard in District Court." 1 Collier on Bankruptcy ¶ 11.02[2] (16th 2018).

[5] *See* https://mediatbankry.com/2016/12/06/a-list-of-bankruptcy-districts-that-have-and-have-not-adopted-local-mediation-rules/ (last visited Feb. 21, 2019)

District	Rule(s)
Southern District of New York	S.D.N.Y. LBR 9019-1; General Order M-452 (*Procedures Governing Mediation of Matters and the Use of Early Neutral Evaluation and Mediation/Voluntary Arbitration in Bankruptcy Cases and Adversary Proceedings*)
Northern District of Texas	N.D. Tex. L.B.R. 9019-2 (one sentence rule)
Eastern District of Virginia	LBR 9019-1
District of Maine	D. Me. LBR 9019-2

In the Bankruptcy Court for the District of Delaware, the authority to direct matters to mediation is established by Del. Bankr. L.R. 9019-3 and 9019-5, which apply to "any dispute arising in an adversary proceeding, contested matter or otherwise in a bankruptcy case." Del. Bankr. L.R. 9019-5(a). While matters involving the U.S. Trustee, a *pro se* party, or injunctive relief are generally beyond the scope of what can be ordered to mediation, Delaware's local rules specifically authorize the bankruptcy court to order such matters to be mediated. *Id.*

In the Southern District of New York, the ADR process for bankruptcy courts is governed by S.D.N.Y. LBR 9019-1 and General Order M-452. Notably, the very first provision in General Order M-452 provides that the Court is authorized to "order assignment of a matter to mediation upon its own motion, or upon a motion by any party in interest or the U.S. Trustee." General Order M-452, ¶ 1.1. In addition, unless ordered otherwise, "any proceeding, contested matter or other dispute may be referred by the Court to mediation." General Order M-452, ¶ 1.3.

Finally, in the Northern District of California, the local rule governing alternative dispute resolution provides that "while participation in the [alternative dispute resolution process] is intended to be voluntary, any Judge, acting *sua sponte* or on the request of a party, may designate specific Matters for inclusion in the program." B.L.R. 9044-1(a). The alternative dispute resolution program in the Northern District of California includes all controversies and disputes in a bankruptcy case, except: "(a) employment and compensation of professionals; (b) compensation

of trustee and examiners; (c) objections to discharge under 11 U.S.C. § 727, except where such objections are joined with disputes of debts under 11 U.S.C. § 523; and (d) matters involving contempt or other types of sanctions." B.L.R. 9041-1.

b. Statutory Authority for Mandatory Mediation

Bankruptcy courts have also relied on Bankruptcy Code section 105 as statutory authority for ordering parties to mediation. While the general powers granted by section 105 may be characterized as encapsulating a bankruptcy court's "inherent powers," courts have analyzed both sections 105(a) and 105(d) as providing an independent statutory authority for bankruptcy courts to order parties to mediation. *See*, *e.g.*, *In re Patriot National Inc.*, Case No. 18-10189, Dkt. No. 264 (Bankr. Del. Mar. 2, 2018), Transcript of Oral Ruling at 145:1-3 ("And the Court, of course, also has the power under Section 105, I think, to stay the actions and to order mediation."); *see also Chemtura*, Tr. at 69:1-70:8; *Bruno v. Mona Lisa at Celebration, LLC (In re Mona Lisa at Celebration, LLC)*, 410 B.R. 710, 716-17 (Bank. M.D. Fla. 2009) (ordering mediation under section 105(a) where "both judicial economy and common sense dictate that the parties, or if needed, the Court, resolve the issues in an organized and unified manner"). In the *Chemtura* case, Judge Gerber reasoned that his authority to compel mediation derived not from section 105(a), but rather from section 105(d), which "grants authority to take such steps as are necessary or appropriate to achieve the expeditious and economical resolution of disputes before it." *Chemtura*, Tr. at 69:9-12.

c. The Bankruptcy Court's Inherent Power

When there are no applicable local rules, bankruptcy courts routinely rely on their inherent powers to mandate that parties participate in mediation. *See*, *e.g.*, *In re A.T. Reynolds & Sons, Inc.*, 424 B.R. 76, 85 (Bankr. S.D.N.Y. 2010) ("While it goes without saying that a court may not order parties to settle, this Court has authority to order the parties to participate in the process of

mediation[.]"), *rev'd on other grounds*, 452 B.R. 374 (S.D.N.Y. 2011); *In re Acme Cake Co., Inc.*, 495 B.R. 212, 219 (Bankr. E.D.N.Y. 2010) (recognizing that "this Court had the authority to direct the parties to mediation" even if the parties did not consent to such mediation order).

In *Atlantic Pipe*, the First Circuit held that district courts have the inherent power to order parties to submit to mandatory mediation. *See Atlantic Pipe*, 304 F.3d at 143-45. Such inherent power, however, is subject to "at least four limiting principles."

> First, inherent powers must be used in a way reasonably suited to the enhancement of the court's processes, including the orderly and expeditious disposition of pending cases. Second, inherent powers cannot be exercised in a manner that contradicts an applicable statute or rule. Third, the use of inherent powers must comport with procedural fairness. And, finally, inherent powers must be exercised with restraint and discretion.

Id. (internal quotations and citations omitted).

Addressing these limitations, the First Circuit focused on the concern with forcing mediation on unwilling participants. Noting that "it stands to reason that the likelihood of settlement is diminished" when parties are forced into mediation, the court recognized that "[r]equiring parties to invest substantial amounts of time and money in mediation under such circumstances may well be inefficient." *Id.* at 144. Nevertheless, "none of these considerations establishes that mandatory mediation is always inappropriate." *Id.* at 144. "Much depends on the idiosyncracies [sic] of the particular case and the details of the mediation order," and there may "be specific cases in which such a protocol is likely to conserve judicial resources without significantly burdening the objectors' rights to a full, fair, and speedy trial." *Id.* The court then concluded:

> In some cases, a court may be warranted in believing that compulsory mediation could yield significant benefits even if one or more parties object. After all, a party may resist mediation simply out of unfamiliarity with the process or out of fear that a willingness to submit would be perceived as a lack of confidence in her legal

> position. . . . In such an instance, the party's initial reservations are likely to evaporate as the mediation progresses, and negotiations could well produce a beneficial outcome, at reduced cost and greater speed, than would a trial. While the possibility that parties will fail to reach agreement remains ever present, the boon of settlement can be worth the risk.
>
> This is particularly true in complex cases involving multiple claims and parties. The fair and expeditious resolution of such cases often is helped along by creative solutions -- solutions that simply are not available in the binary framework of traditional adversarial litigation. Mediation with the assistance of a skilled facilitator gives parties an opportunity to explore a much wider range of options, including those that go beyond conventional zero-sum resolutions. Mindful of these potential advantages, we hold that it is within a district court's inherent power to order non-consensual mediation in those cases in which that step seems reasonably likely to serve the interests of justice.

Id. at 144-45 (internal quotations and citations omitted).

d. Limited Use of Federal Rules In Support of Mandatory Mediation

Some commentary asserts that a bankruptcy court has authority to mandate mediation pursuant to Rule 16 of the Federal Rules of Civil Procedure, which is made applicable to bankruptcy cases by Rule 7016 of the Federal Rules of Bankruptcy Procedure. Rule 16 states, in relevant part, that:

> At any pretrial conference, the court may consider and take appropriate action on the following matters: . . . (I) settling the case and using special procedures to assist in resolving the dispute when authorized by statute or local rule[.]

Fed. R. Civ. P. 16(c)(2)(I). By its express terms, however, Rule 16 does not appear to be an independent basis to order mediation. In addition, pursuant to Bankruptcy Rule 9014, Rule 16 is not applicable to contested matters. *See* Fed. R. Bankr. P. 9014(c). In *Atlantic Pipe*, the Court declined to find authority for ordering mandatory mediation within the purview of Rule 16 when there was no statute or local rule authorizing mandatory mediation in the applicable district. The

Atlantic Pipe court recognized the following advisory committee's note as support for not expanding the use of Rule 16:

> The rule acknowledges the presence of statutes and local rules or plans that may authorize use of some [ADR] procedures even when not agreed to by the parties. The rule does not attempt to resolve questions as to the extent a court would be authorized to require such proceedings as an exercise of its inherent powers.

Fed. R. Civ. P. 16, Advisory Committee's note (1993 Amendment) (internal citations omitted).

2. Scope of "Good Faith" Participation in Court Mandated Mediation

In court mandated mediation, the nature and extent of a party's cooperation in the process may be challenged. Either pursuant to the court's local rules or as part of a mediation order, it is common for the party seeking to compel mediation to require that the compelled participants participate in "good faith." In such mediation orders, it is often the responsibility of the mediator to report to the court "any willful failure to attend in good faith in the mediation process or conference." *See*, *e.g.*, General Order M-452 (Bankr. S.D.N.Y). The scope of the term "good faith" is not universally understood and, as a subjective concept, has led to some confusion in the case law. *See A.T. Reynolds*, 452 B.R. at 381 ("Courts have not developed any clear standards for evaluating good faith in court-ordered mediation."). Notwithstanding this lack of precision, "courts have interpreted good faith narrowly to require compliance with orders to attend mediation, provide pre-mediation memoranda, and, in some cases, produce organizational representatives with sufficient settlement authority." John Lande, *Using Dispute System Design Methods to Promote Good–Faith Participation in Court–Connected Mediation Programs*, 50 UCLA L. Rev. 69, 84 (2002).

In *A.T. Reynolds*, the district court reversed the bankruptcy court's requirement that a party's "good faith" participation in mediation required a "discussion" and "risk analysis." *See A.T. Reynolds*, 452 B.R. at 383-84. The court reasoned that if "good faith" required such conduct,

then a court's inquiry into a party's level of participation at the mediation would likely destroy the confidential nature of the mediation. *Id.* Ultimately, the court reasoned that these additional requirements would do more harm than good and result in mediation becoming improperly coercive. *Id.*

While Rule 16 may not independently provide authority to order parties to mediate, it is appropriate authority for the court to award sanctions for failure to mediate in good faith. *See Nick v. Morgan's Foods, Inc.*, 270 F.3d 590, 595 (8th Cir. 2001) (failure to provide a memorandum to the mediator presenting a summary of disputed facts and a narrative description of its position on liability established lack of good faith). *See Bulkmatic Transp. Co.*, 2002 WL 975625 at *1 ("Although a court cannot force litigants to settle an action, it is well established that a court can require parties to appear for a settlement conference, and impose sanctions pursuant to Rule 16(f) if a party fails to do so."); *see also Spradlin v. Richard*, 572 F. App'x 420, 428 (6th Cir. 2014) ("We conclude that the bankruptcy court's award of sanctions was not an abuse of discretion" under Rule 16(f)). In addition, sanctions have been assessed where parties failed to meet the most elemental levels of participation, including attendance and preparedness. *See Negron v. Woodhull Hosp.*, 173 Fed.Appx. 77, 79 (2d Cir. 2006) (holding district court "properly required the [sanctioned party] pay the expenses incurred in preparing for the mediation" because of sanctioned party's failure to bring a principal party with settlement authority); *see also Thrane v. Metro. Transportation Auth.*, 2018 WL 840043, at *4 (E.D.N.Y. Feb. 12, 2018).

3. Scope of the Bankruptcy Court's Authority to Order Certain Matters to Mediation

Bankruptcy courts are courts of limited jurisdiction and, therefore, parties have attempted to oppose a request for mandatory mediation on the basis that the court lacks either personal or subject matter jurisdiction. *See Chemtura*, Tr. at 62:15-66:19; *see also Patriot National*, Tr. at 144:22-145:1. In particular, this may be common in the early stages of a chapter 11 case (*i.e.*,

before the claims bar date, commencement of litigation, etc.) because it may be unclear whether a party identified as essential to a global settlement is actually subject to the bankruptcy court's jurisdiction. If successful, then such a challenge could limit the use of mandatory mediation as part of pre-plan negotiations or other early case dispositive matters.

In *Chemtura*, the bankruptcy court rejected an insurance provider's argument that the court did not have the authority to compel the insurer to attend and/or participate in mediation. The court found:

> I have no doubt that I have subject matter jurisdiction to enter the proposed order. First, the [insurers] have filed claims in this case, thereby subjecting themselves to the jurisdiction of this Court, both as an in persona matter and as a subject matter jurisdiction matter, triggering the Court's arising in jurisdiction, the second of the three prongs under which 28 U.S.C., Section 1334 provides jurisdiction to the district courts and hence the bankruptcy courts of the United States. This is so not only with respect to any additional amounts they would like to get from the estate on account of either premiums or reimbursement obligations but also matters related to the policies upon which they filed claims.

Chemtura, Tr. at 64:19-65:6. The court further found that:

> The extent to which the [insurers] meet any obligations on their policies . . . will have a significant effect on the other creditors with disputed claims whose recoveries will rest on the residual size of the claims reserve and of course will also have an effect on other estate interests such as those of the estate's equity security holders who will have claims to the residual value of the claims reserve under the waterfall provisions of the plan."

Id. at 65:22-66:5. Thus, the court held that it had "jurisdiction over all of the underlying controversies between the debtors and the [insurers] which gives [it] jurisdiction to manage the resolution of those controversies." *Id.* at 66:15-19.

Similarly, in *Patriot National*, the bankruptcy court found it had jurisdiction over a party opposing the debtor's request for court ordered mediation where the objecting party had commenced federal suits against the debtor, the debtor's former CEO, and the debtor's current and

former directors. In its reply, the debtor argued that the bankruptcy court had "related to" jurisdiction over the federal actions because the plaintiff had asserted a direct claim against the debtor, as well as claims against the debtor's officers and directors who, in turn, had indemnification rights against the debtor. The court agreed with the debtor, holding that "the litigations -- are related to the litigation -- to the bankruptcy -- and related-to jurisdiction, include suits between third parties which have an effect on the bankruptcy estate. And that is what we have here." *Patriot National*, Tr. 144:22-145:1.

The Sixth Circuit weighed into an aspect of this issue in *Spradlin v. Richard*, 572 F. App'x 420 (6th Cir. 2014). After the complaint was filed and defendants moved to dismiss for lack of subject matter jurisdiction, the bankruptcy court ordered the parties to mediate their claims without ruling on the motion to dismiss. After the mediator determined that the defendants' participation in mediation demonstrated bad faith, the plaintiff sought sanctions against the defendants "for unpreparedness and bad faith in the mediation process." *Spradlin*, 572 F.App'x at 423. The bankruptcy court ultimately dismissed the complaint for lack of subject-matter jurisdiction over most claims (and declined to exercise supplemental jurisdiction over the remaining claims), but retained jurisdiction over the plaintiff's request for sanctions. Thereafter, the bankruptcy court awarded sanctions against one of the defendants, who was appealed to the Sixth Circuit. In ruling that the bankruptcy court may award sanctions against a party whose underlying claim was not subject to the court's jurisdiction, the Court of Appeals reasoned that "federal courts maintain jurisdiction over certain collateral issues even after the underlying action is dismissed for lack of jurisdiction." *Id.* at 427. The court explained its reasoning that "just because a federal court is later found to lack subject matter jurisdiction in a particular matter does not give litigants a free pass with respect to any and all prior indiscretions they may have committed before the court." *Id.*

(citing *River City Capital, L.P. v. Bd. of County Comm'rs, Clermont Cnty.*, Ohio, 491 F.3d 301, 310 (6th Cir.2007)).

4. Conclusion

Court mandated mediation may grow in frequency as the pace of complex chapter 11 cases require more efficient and creative restructuring solutions. Bankruptcy courts, recognizing that sometimes the "boon of settlement can be worth the risk,"[6] may, at the request of a party or *sua sponte*, enter mediation orders that establish a process conducive to reaching (but certainly not requiring) global settlements or resolutions of case determinative issues. Parties that may be impacted by a mandated mediation process should consider the associated opportunities and risks. If a party in interest is left outside of the proposed mediation order, it may seek relief to be included, or intentionally sit on the sidelines. For a party that may be required to mediate, it should consider whether it will willingly participate or challenge the court's jurisdiction over the party or underlying dispute. Finally, court mandated mediation generally requires "good faith" participation and parties must familiarize themselves with the applicable law to avoid any risk of sanctions. Ultimately, in order for it to be successful, compulsory mediation requires any reluctant party to convert to a willing participant and, potentially, yield significant results.

[6] *Atlantic Pipe*, 304 F.3d at 145.