Mediating Valuation, Intercreditor and Other Issues Affecting Secured Creditors in Bankruptcy

Presented by the Mediation and Secured Credit Committees

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A FEW BANKRUPTCY MEDIATION TOPICS[1]

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The use of mediation in bankruptcy disputes is becoming increasingly commonplace. Overall, the attorneys for the parties and many courts have a greater understanding as to the benefits of mediation at different phases in a case. While mediation is an increasingly attractive option to parties, a recent decision from a bankruptcy court in Texas raises certain criticisms of mediation and reflects continued resistance to mediation in certain situations. These materials explore the evolving use of mediation in bankruptcy practice, the evaluative and facilitative approaches to mediation, as well as the use of judges as mediators.

I. The Growth of Mediation.

A. Historical Criticism of Mediation.

1. Twenty years ago there were a lot of lawyers and judges that did not think that mediation was a useful process.
2. Some critics were concerned with additional costs.
3. Some attorneys felt that they were capable of settling a case on their own and did not need outside help.

B. Developments in Mediation.

1. Today much of the criticism has receded and mediation is more widely used in many courts. *See* Thomas J. Stipanowich and J. Ryan Lamare, Living with ADR:

[1] This paper was originally presented at the Southeastern Bankruptcy Law Institute conference on April 2, 2016. It has been modified for this presentation.

Evolving Perceptions and Use of Mediation, Arbitration and Conflict Management in Fortune 1000 Corporations, 19 Harv. Negotiation L. Rev. 1 (2014).

2. The Alternate Dispute Resolution Act of 1998 (the "ADR Act") requires: (a) district courts to develop rules for alternative dispute resolution, and (b) parties to consider alternative dispute resolution in all civil actions. 28 U.S.C. § 651 et seq.
3. The ADR Act applies to all civil actions, specifically including adversary proceedings in bankruptcy cases.
4. Many bankruptcy courts have adopted local rules dealing with alternative dispute resolution and more particularly mediation. States where such districts exist include California, New York, Delaware, and Massachusetts, among many others.
5. The American Bankruptcy Institute Mediation Committee has promulgated model rules for mediation which would apply in contested matters, adversary proceedings and any dispute arising in a bankruptcy case. *See*, Attachment A.

C. Mediation Continues to Face Some Resistance.

1. There still are districts where mediation is not widely favored. A recent decision from Hon. Jeff Baum, Chief United States Bankruptcy Judge for the United States Bankruptcy Court for the Southern District of Texas (Houston Division), illustrates one judge's concerns about the usefulness of mediation. *See In re Smith*, 524 B.R. 689 (Bankr. S.D. Tex. 2015).

II. Choosing the Evaluative or Facilitative Approach to Mediation

A. Mediators Tend to Favor One Approach Over The Other.

1. Often, mediators tend to follow either an evaluative method, or a facilitative method. However, it is often common for a mediator to be flexible in approach

and deploy hybrid approaches that, may, start facilitative and may ultimately include evaluative aspects. This is highly controversial in the mediation field and many mediators and commentators feel strongly about this issue.

B. The Evaluative Mediation.

1. An evaluative mediation typically involves a mediator that, to some extent, tries to control the process by driving the parties toward resolution.
2. The mediator often offers opinions or predictions about the likely outcome of the case, essentially telling the parties who he or she thinks will win and why, and warns the parties about the litigation risks of not settling.
3. An evaluative process may bring up issues that the parties may not have fully considered such as additional expenses, evidentiary hurdles, limitations on damages, the quality of witnesses who will testify on one side or the other, the predilections of the judge who will preside at trial, and the economic and emotional costs of proceeding to trial.
4. The mediator applying an evaluative method might be quite assertive in offering advice and might make recommendations designed to lead the parties to the resolution favored by the mediator based on the mediator's experience or analysis.
5. Sometimes, an evaluative mediator might try to drive the parties to a resolution that the mediator believes both parties will accept in order to arrive at a deal.

C. Benefits of Evaluative Mediation.

1. Attorneys for parties in mediation often request an evaluation from a mediator and consider this an important aspect to the mediator's role.

2. Sometimes a forceful "brow beating" by a third party with no interest in the outcome can lead to a resolution.
3. Sometimes parties are more comfortable in reaching resolution when an independent party agrees that the resolution is fair.
4. Sometimes a mediator will direct the process toward a resolution that the mediator chooses.
5. Sometimes a mediator favoring the position of one side may influence the other side toward capitulation.

D. Criticism of Evaluative Mediation.

1. When the mediator expresses an opinion about the relative chances of success of all sides, he or she may alienate the party predicted to lose. For example, if the mediator determines that one side has a 90% chance of success and the other a 10% chance of success, the mediator runs the risk of appearing less than independent and may find it difficult to further engage the 10% party in further productive discussions.
2. The side the mediator favors may feel it unnecessary to re-evaluate its position even if a re-evaluation could be helpful to the process. Thus, the predicted winner may become more entrenched in their position and less willing to compromise or otherwise work toward a solution. Further bargaining and reaching resolution may therefore become more difficult.
3. Evaluative mediation may violate ethical mediation requirements. The Model Standards of Conduct for Mediators has been adopted by the American Bar Association, the American Arbitration Association and the Association for

Conflict Resolution (the "Rules"). The Rules were revised and adopted by each organization in 2005. Standard II(B) provides:

> (B) A mediator should not conduct mediation in an impartial manner and avoid conduct that gives the appearance of partiality.
> (1) A mediator should not act with partiality or prejudice based on any personal characteristics, values and beliefs, or performance at mediation, or for any other reasons.

Some commentators express that the view that these provisions do not allow for evaluative mediation. *See* Kimberlee K. Kovach & Lela P. Love, *Evaluative Mediation is an Oxymoron*, 14 ALTERNATIVES TO THE HIGH COSTS LITIG. 31 (1996); Robert B. Moberly, *Symposium: Mediator Gag Rules: Is it Ethical for Mediators to Evaluate or Advise?*, 38 S. TEX. L. Rev. 669, 670-75 (1997), Lela P. Love, *Symposium: The Top Ten Reasons Why Mediators Should Not Evaluate*, 24 FLA. ST. U. L. REV. 937, 938 (1997).

4. Evaluative mediators would certainly not agree with that analysis. We have found no decisions on this point.

5. When a mediator evaluates, that act may diminish the self determination of the parties. *See* Scott H. Hughes, *Alternative Dispute Resolution: Facilitative Mediation or Evaluative Mediation: May Your Choice Be a Wise One*, 59 ALA. LAW. 246, 247 (July 1998). This is an important goal of mediation. The Rules, in Standard 1, provide that:

> A. A mediator shall conduct a mediation based on the principle of party self determination. Self-determination is the act of coming to a voluntary, uncoerced decision in which each party makes free and informed choices as to process and outcome. Parties may exercise self-determination at any stage of

mediation, including mediator selection, process design, participation in or withdrawal from the process, and outcomes.

1. Although party self-determination for process design is a fundamental principle of mediation practice, a mediator may need to balance such party self-determination with a mediator's duty to conduct a quality process in accordance with these Standards.

2. A mediator cannot personally ensure that each party has made free and informed choices to reach particular decisions, but, where appropriate, a mediator should make the parties aware of the importance of consulting other professionals to help them make informed choices.

B. A mediator shall not undermine party self-determination by any party for reasons such as higher settlement rates, egos, increased fees, or outside pressures from court personnel, program administrators, provider organizations, the media or others.

6. An evaluative mediator might well adopt one side's view of the facts and one side's view of the law in making his or her evaluation. There are no effective checks for correctness or credibility of the source.

7. If the parties really want an independent evaluation, they could engage an independent evaluator. This is a different role than a mediator. As discussed above, the independent evaluator may find it difficult to assume the role of mediator after expressing his views of the case.

8. Parties may take a different approach to mediation if they feel that the mediator is going to evaluate. It might be very important to convince the mediator of each side's position before the evaluation. The parties may maintain an adversary position rather than searching for a mutual resolution.

E. The Facilitative Mediation.

1. The mediator will usually try to help the parties evaluate their own views of the case and formulate their own proposals.
2. The mediator will clarify discussions so that each party understands the other side's position. Lack of this clarity often leads the parties to harden positions because they are sure the other side's position is unreasonable, even when it may not be.
3. The mediators will try to encourage discussion between the parties either by direct communication or shuttle diplomacy.
4. Shuttle diplomacy typically involves the mediator going from caucus room to caucus room, if that seems the best way to facilitate communication.
5. A facilitative mediator is most likely to consider the mediation to be that of the parties and will consider the parties comfort that they are in control to be a paramount consideration.
6. The mediator will usually not give the parties the mediator's view of the outcome but will try to influence the parties using techniques that differ from trying to get the parties to see the mediator's view of the situation.
7. The mediator will ask questions, leading to further analysis of the circumstances and applicable law, or to illicit possible weaknesses in a party's case. For example, what are you going to do about this defense when the other side raises it? What position are you going to take when a particular document is offered into evidence?
8. Facilitative mediators may try to bring the principals into the discussions, rather than just the lawyers.

9. The facilitative mediator may try to reduce the vitriol and bad feeling between the parties to encourage a solution based discussion. Ground rules may be established to, for example, bar name calling or characterizations of perceived motives.

F. Benefits of Facilitative Mediation.

1. Allows the parties to reach their own resolution, guided by the mediator.
2. Generates trust in the mediators independence.
3. Looks to the real interests of the parties rather than the law and the facts as expressed in briefs.
4. A resolution is more likely to reflect those interests rather than reflecting the kind of up or down decision that a judge or an arbitrator might make. This means that the parties can craft a resolution that might be a "win-win" for both parties, or at least reflect the needs and interest better than the "win-lose" result of a court decision.

G. Criticism of Facilitative Mediation.

1. Sometimes it takes longer to reach a resolution. This can be frustrating to parties, and increase the cost of mediation.
2. Sometimes parties and their attorneys want a mediator that will convince another side that they are wrong, and are disappointed if that is not done. However, each side may be disappointed if an evaluative mediator decides to bash their position rather than that of the opposition. *See,* C. Edward Dobbs, *Mediation in Bankruptcy Cases—A Mediator's Perspective*, American Bankruptcy Institute 18th Annual Southeast Bankruptcy Workshop (2013) ("Dobbs Article").

3. There is generally little academic criticism of facilitative mediation. Proponents of evaluative mediation don't tend to criticize facilitative mediation; they just seem to favor a more directive style. Proponents of facilitative mediation tend to more critical of evaluative mediation. In reality both are being practiced, often by the same mediator depending on the situation. One of the authors of this paper tends to favor a more facilitative mediation style, while occasionally treading close to the "dark side". One commentator notes "It is too late for commentators or mediation organizations to tell practitioners who are widely recognized as mediators that they are not, in the same sense that it is too late for the Pizza Association of Naples, Italy to tell Domino's that its product is not the genuine article." *See*, Leonard L. Riskin, *Understanding Mediators' Orientations, Strategies and Techniques: A Grid for the Perplexed*, 1 HARV. NEGOTIATION L. REV. 7, 13 (1996).

III. Judges as Mediators.

A. Sitting, Non-Presiding Judge as Mediator.

1. Attorneys may be concerned that their behavior at mediation will influence the judge in another case. Sometimes parties may fear that discussions will be held between the judge mediator and the judge in the case. While this is almost never the case, it can concern parties.
2. Some judges are excellent mediators, others are not. A judge is well trained as a decider of facts and interpreter of law, not as a neutral.
3. Will the parties defer to the judge mediator's authority and is this beneficial or harmful to the process?

4. Is a sitting judge using the evaluative approach more likely to find success than a mediator who is not a judge? The authors would think so. The question is whether this is good or bad. On one hand it may lead to quicker and cheaper resolution. On the other hand will the result reflect party self determination?
5. The goal of mediation is to find a resolution. It does not have to be the best or most fair result. That is of course a very different standard than standard applied by the presiding bankruptcy judge when he or she considers a settlement under Bankruptcy Rule 9019. The question is whether a presiding bankruptcy judge will be as willing to reject a proposed settlement if a colleague was the mediator. After all, the presiding judge would have asked his or her colleague to spend the time and energy necessary to prepare and conduct the mediation. Rejecting the proposed settlement might not be warmly received by the colleague and might impact availability for the next case. It is certainly objectively different from when a private party is the mediator.
6. Mediation before a sitting judge is usually free. That certainly has an appeal to the parties who would otherwise have to pay for the mediation.

B. Retired judges as mediators.

1. Issues of cronyism. *See generally*, *Smith*, 52 B.R. 689...
2. Has the former judge taken mediation training? Experience as a judge is quite different from training as a mediator. The authors' view is that a former judge who has taken mediation training may be a fine choice as a mediator.

3. Will the former judge mediator, if evaluative; be given too much latitude because the parties may perceive more insight into the sitting judge's attitudes on the matter than reflects reality.

4. Some really good mediators are former judges and some are experienced practitioners. In the authors view, the key to success as a mediator is to recognize the benefits of mediation training. Being a great judge does not automatically make you a great mediator. Being a great lawyer does not make you a great mediator. Either experience along with training to be a mediator is most likely to produce high quality mediators. People that have experience representing debtors are most likely to become really good mediators because the skill set is the same. A debtors counsel usually has to bring multiple warring parties together on a deal that will work. However, mediation training is still essential to reach one's full potential as a mediator, whether or not you have been a judge, have practiced on the front lines of bankruptcy cases, or have been a financial advisor or an investment banker. Mediation is sufficiently different from other roles that training in mediation can only be of benefit.

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CONFIDENTIALITY IN MEDIATION

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1. SOURCES OF CONFIDENTIALITY IN MEDIATION

The Alternate Dispute Resolution Act of 1998, 28 U.S.C. §§651-658

> §652(d). Each district court shall adopt local rules to provide for the confidentiality of the alternative dispute resolution process and to prohibit disclosure of confidential dispute resolution communications.

Court Mediation Programs.

ABI Model Local Rules for Bankruptcy Mediation

> Model Rule 1(d). The mediator and all Mediation Participants are prohibited from divulging any Mediation Communication and same are not admissible in evidence or discoverable. The mediator shall not be compelled to testify.

U.S. Bankruptcy Court Local Bankruptcy Rules

U.S. District Court Local Civil Rules

U.S. Circuit Court Local Appellate Rules

State Court Local Rules

Rules of Evidence.

Fed. R. Evid. 408. Not admissible to prove or disprove the validity of a claim.

Uniform Mediation Act.

National Conference of Commissioners on Uniform State Laws.
http://www.uniformlaws.org/shared/docs/mediation/uma_final_03.pdf

> Section 4. Privilege. A mediation communication is privileged and is not discoverable or admissible in evidence.
>
> Section 5. Waiver.
>
> Section 6. Exceptions: written settlement agreement, crime.

Model Standards of Conduct for Mediators.

American Arbitration Association, American Bar Association, Association for Conflict Resolution
http://www.americanbar.org/content/dam/aba/migrated/dispute/documents/model_standards_conduct_april2007.authcheckdam.pdf

Standard 5. A mediator shall maintain the confidentiality of all information obtained in the mediation. Exceptions: parties consent or parties make different rule for confidentiality.

American Arbitration Association (AAA)

Commercial Mediation Procedures
https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTG_004103

M-10. Confidential information shall not be disclosed by the mediator. The parties shall maintain the confidentiality of the mediation.

Federal Arbitration, Inc. (FedArb)

Rules for Arbitration and Mediation
http://www.fedarb.com/rules/fedarb-rules/#_Toc178331754

Rule 10.04. Unless all the parties otherwise agree, all papers, exchanges, hearings, and decisions in any FedArb proceeding shall be and shall remain confidential, except to the extent that the information has been previously disclosed, or disclosure is necessary in connection with a judicial challenge to or enforcement of an Award, or disclosure is required by law.

Judicial Arbitration and Mediation Service (JAMS)

JAMS International Mediation Rules
http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS-International-Mediation-Rules.pdf

Rule 11. All information, etc. received by a mediator will be confidential. The mediator will not be compelled to divulge such information or to give evidence. The parties will maintain confidentiality.

Mediation Agreement.

Parties may establish particular rules for confidentiality.

2. **CASE LAW ON CONFIDENTIALITY IN MEDIATION**

Willingboro Mall, LTD. v. 240/242 Franklin Avenue, L.L.C., 215 N.J. 242 (2013).

Commercial foreclosure action referred to mediation by the court. Defendant informed court that matter had settled after mediation. Plaintiff refused to sign documents to implement settlement. Defendant moved to compel settlement and attached a certification of the mediator attesting to the settlement. Plaintiff did not object to mediator's certification but requested an evidentiary hearing. Plaintiff disclosed mediation communications. Both parties consented to a court order compelling the mediator to testify. Held: Plaintiff waived the mediation privilege by failing to object to mediator's certification, revealing mediation communications itself, and consenting to the order compelling mediator's testimony. In the future following mediation, New Jersey courts will require a signed, written settlement agreement to be enforceable.

Savage & Associates, P.C. v. K&L Gates LLP (In re Teligent, Inc.), 640 F.3d 53 (2d Cir. 2011).

Law firm moved to lift protective orders for mediation communications. A party seeking disclosure of confidential mediation communications must demonstrate: (1) a special need for the confidential material, (2) resulting unfairness from a lack of discovery, and (3) that the need for the evidence outweighs the interest in maintaining confidentiality. Held: Extraordinary circumstances did not exist to warrant disclosure of confidential mediation communications. Law firm did not prove compelling need for confidential information.

Dandong v. Pinnacle Performance Limited, 2012 WL 4793870 (S.D.N.Y. Oct. 9, 2012)

Investors and securities distributors entered into private mediation before the Financial Industry Disputes Resolution Center ("FIDReC"). Defendants in securities litigation sought discovery of information presented by the investors in the mediation and plaintiffs sought a protective order. The Magistrate Judge granted the protective order in part but ordered disclosure of plaintiffs' own statements during mediation about the basis for their investments and the materials on which they relied. Plaintiffs objected to the magistrate judge's ruling and the matter came before the district judge. First, the district judge agreed with the magistrate judge that the Second Circuit's *Teligent* test for disclosure of confidential mediation statements applied to private mediation as well as mediation pursuant to a court order. The district judge reversed the magistrate judge's decision because use of statements in mediation for impeachment is not a special need.

In re A.T. Reynolds & Sons, Inc., 2011WL 1044566 (S.D.N.Y. 2011).

Bankruptcy Court ordered debtor and lender to mediation. Mediator reported that lender did not participate in mediation in good faith and provided details of mediation session. Bankruptcy Court held lender in contempt and issued sanctions. District Court reversed. "Confidentiality concerns preclude a court from inquiring into the level of a party's participation in mandatory court-ordered mediation…. This does not mean that all conduct in a mandatory mediation is outside the scope of a court's inquiry into good faith. Where, for example, a party demonstrates dishonesty, intent to defraud, or some other improper purpose, the benefits of inquiry into such conduct may outweigh considerations of coercion and confidentiality."

Beazer East, Inc. v. The Mead Corporation, 412 F.2d 429 (3d Cir. 2005).

Appellant sought to enforce alleged settlement agreement reached during appellate mediation. Court denied request because to do so would violate Local Appellate Rule that prohibits disclosure of any statements made during mediation. "Both Local Appellate Rule (LAR) 33.5 and sound judicial policy compel the conclusions that parties to an appellate mediation session are not bound by anything short of a written settlement. Any other rule would seriously undermine the efficacy of the Appellate Mediation Program by compromising the confidentiality of settlement negotiations."

In re Washington Mutual, Inc., 461 B.R. 200 (Bankr. D. Del. 2011) vacated in part 2012 WL 1563880 (Bankr. D. Del. Feb. 24, 2012).

Creditors holding debt securities participated in confidential settlement negotiations regarding disputed ownership of assets among the debtor/bank holding company, purchaser of bank and the FDIC. Equity Committee stated colorable claim that creditors may have traded on material non-public information (MNPI) learned during settlement negotiations. Bankruptcy Court granted standing to Equity Committee to pursue equitable disallowance of creditors' claims. That part of the opinion was later vacated to facilitate a consensual plan of reorganization supported by the Equity Committee.

Cengage Fix. Mediation order provided that no party to the mediation shall become an insider, temporary insider, or fiduciary to the debtor.

452 B.R. 374
United States District Court,
S.D. New York.

In re A.T. REYNOLDS & SONS, INC., d/b/a Leisure Time Spring Water, Debtor.

No. 10 Civ. 2917(WHP).
|
March 18, 2011.

Synopsis
Background: Purchaser that acquired Chapter 11 debtor as going concern moved for payment of wage claims of debtor's employees for week preceding sale's effective date. After mediator for court-ordered mediation advised that secured creditor had failed to participate in good faith, order to show cause was issued directing secured creditor and its counsel to show cause why they should not be sanctioned for contempt. The Bankruptcy Court, Cecelia G. Morris, J., 424 B.R. 76, held secured creditor and its counsel in contempt and imposed sanctions on them for failure to comply with a mediation order, and they appealed.

Holdings: The District Court, William H. Pauley III, J., held that:

[1] secured creditor was within its rights to enter the mediation with the position that it would not make a settlement offer;

[2] confidentiality considerations preclude a court from inquiring into the level of a party's participation in mandatory court-ordered mediation;

[3] secured creditor sent to the mediation a representative with sufficient settlement authority; and

[4] the bankruptcy court's finding that secured creditor attempted to "control the procedural aspects of the mediation" was clearly erroneous.

Reversed.

Attorneys and Law Firms

***376** Nicholas Anthony Pascale, Steven Louis Tarshis, Tarshis, Catania, Liberth, Mahon & Milligram Newburgh, NY, for Debtor.

MEMORANDUM & ORDER

WILLIAM H. PAULEY III, District Judge.

Appellants Wells Fargo Bank, N.A. ("Wells Fargo") and Ruskin Moscou Faltischek, P.C. ("Ruskin") appeal from an order of the United States Bankruptcy Court, Southern District of New York (Morris, J.) dated February 5, 2010, sanctioning Wells Fargo and Ruskin for failure to comply with a mediation order and holding them in contempt. As this appeal demonstrates, the specter of sanctions and contempt spawns ancillary litigation that often eclipses the issues at the heart of the underlying proceeding. For the following reasons, the Bankruptcy Court's order is reversed.

BACKGROUND

I. *Bankruptcy Proceedings*
This dispute arises out of the Chapter 11 bankruptcy of A.T. Reynolds & Sons, Inc. ("A.T. Reynolds") in 2008. During the bankruptcy proceedings, A.T. Reynolds and Wells Fargo jointly stipulated to two interim orders, under which, *inter alia,* Wells Fargo provided A.T. Reynolds with a cash collateral account to use in conjunction with the sale of A.T. Reynolds assets to Boreal Water Collection, Inc. ("Boreal"). At the sale hearing, New York State Electric and Gas Corporation ("NYSEG") sought payment of $35,256.23 for unpaid utility bills (the "Utility Payment"). (Hr'g Tr. dated March 27, 2009 ("3/27 Tr.") 37–38.) After negotiations, Wells Fargo agreed to make the Utility Payment, and Boreal Water Collection, Inc. ("Boreal"), the prospective buyer of A.T. Reynolds assets, agreed to a small increase in the interest rate in its payments to Wells Fargo. (3/27 Tr. 67–68.) Boreal finalized the purchase of A.T. Reynolds on April 3, 2009. (Docket No. 175.)

***377** On July 8, 2009, Boreal brought a claim against A.T. Reynolds for unpaid wages (the "Wage Claim"). (Docket No. 103.) Boreal also contended that rather than

paying the Utility Payment out-of-pocket, Wells Fargo "utilized the monies in the [A.T. Reynolds] cash collateral account" (Docket No. 103 ¶ 7) that could have been used to pay the Wage Claim. (Hr'g Tr. dated Aug. 25, 2009 ("8/25 Tr.") 8.) The Bankruptcy Court ordered that the issue be mediated. (8/25 Tr. 10; Docket No. 224.)

The Bankruptcy Court's Mediation Order incorporated General Order M–390 of the United States Bankruptcy Court, Southern District of New York, which provides in relevant part:

> 3.2. **Mediation Conference.** A representative of each party shall attend the mediation conference, and must have *complete authority to negotiate all disputed amounts and issues. The mediator shall control all procedural aspects of the mediation.* The mediator shall also have the discretion to require that the party representative or a non-attorney principal of the party with *settlement authority* be present at any conference.... The mediator shall report any willful failure to attend or to participate *in good faith* in the mediation process of conference. Such failure may result in the imposition of sanctions by the court.

In re Adoption of Procedures Governing Mediation, General Order M–390 Amending and Reinstating M–143 and M–211 (Bankr. S.D.N.Y. Dec. 1, 2009) (emphasis added).

II. *Pre–Mediation Conduct*

Robert Goldman was chosen as the mediator ("Mediator") on September 24, 2009 (Docket No. 227), and Wells Fargo attempted to discern from him the topics of discussion at the mediation. In response, counsel for A.T. Reynolds suggested the following:

1. Whether Wells Fargo represented to the Court at the ... sale of the debtor's business that the utility bill would be paid by Wells;

2. Whether there was any agreement between Boreal and Wells, as alleged by Boreal, to have an additional interest point paid by Boreal to Wells at the ... closing to make sure the utility was paid, if that point was paid, how it was applied;

3. Whether Wells (intentionally or otherwise) double-dipped by taking both the point from Boreal and by sweeping the Debtor's cash collateral account to pay the same Utility bill, which resulted in insufficient funds to pay wages to debtors employees;

4. Whether Wells violated the cash collateral order, and/or breached its deal with Boreal in so doing;

....

And, *any other issues anyone wants to discuss* of course.

(Affidavit of Jeffrey A. Wurst dated Dec. 14, 2009 ("Wurst Aff.") Ex. C: Email from Jeffrey Wurst to Robert Goldman (Oct. 16, 2009, 9:29) (emphasis added).) Wells Fargo was concerned with the catch-all "any other issue" provision and sought to confirm that only the enumerated issues would be raised. (Wurst Aff. Ex. C: Email from Jeffrey Wurst to Robert Goldman (Oct. 16, 2009, 9:29).) The Mediator responded that he "ha[d] no clue what the case is about" and that "we will go where the river takes us." (Wurst Aff. Ex. C: Email from Robert Goldman to Jeffrey Wurst (Oct. 16, 2009, 11:46).) Unsatisfied, Wells Fargo replied that:

> [B]efore we can prepare any statement for you [about our legal position] we ***378** need to know what it is that is being submitted to mediation.... Nothing productive can be achieved from a "free for all" mediation. Certainly we cannot be prepared to discuss any issue that is not first on the proverbial table.... We will be prepared to discuss only the ... items enumerated.... In the event any additional issues are raised we will address them at the mediation only if we feel we are able to without the benefit of reviewing any documents or other preparation.

(Wurst Aff. Ex. C: Email from Jeffrey Wurst to Robert Goldman (Oct. 16, 2009, 16:53).)

Wells Fargo was also concerned that Boreal would fail to send a client representative. To that end, Wells Fargo stated that "neither Wells Fargo nor its counsel will attend any mediation where Wells Fargo is the only party with client presence" because "absent the participation of a Boreal business person nothing can be accomplished." (Wurst Aff. Ex. E: Email from Jeffrey Wurst to Robert Goldman (November 13, 2009, 14:32).) The mediator responded that "[i]t is my understanding that all parties will have a party representative present" but declined to provide any further assurances. (Wurst Aff. Ex. E: Email from Robert Goldman to Jeffrey Wurst (November 13, 2009, 15:00).)

III. *The Mediation*

The mediation was held on November 17, 2009 at the United States Bankruptcy Court in Poughkeepsie and was attended by Wells Fargo Vice President Evan Zwerman ("Zwerman") and Ruskin attorney Daniel McAuliffe ("McAuliffe"). (McAuliffe Aff. ¶ 2.) Although Zwerman did not have unlimited settlement authority, he had the authority to settle the dispute for up to the amount in controversy. (Zwerman Aff. ¶ 6.)

The mediation reached an impasse soon after it began. As counsel for Boreal offered a short summary of its position, McAuliffe interjected to express disagreement. [1] (Hr'g Tr. dated Dec. 31, 2009 ("12/31 Tr.") Tr. 81.) The Mediator requested that McAuliffe momentarily reserve his point. But McAuliffe persisted. The Mediator then spoke to the Wells Fargo representatives alone in a side session to circumvent the "complete roadblock." (12/31 Tr. 82–83.) That side session lasted over an hour. And McAuliffe reiterated to the Mediator that Wells Fargo would not agree to any solution that involved a monetary payment. (12/31 Tr. 83.) The Mediator asserts that during the side session Wells Fargo "did not go through risk analysis, [and][t]hey went simply to reiterate the position they walked into the room with...." (12/31 Tr. 85.)

[1] Due to the confidential nature of the mediation, the Bankruptcy Court cautioned the parties at the December 31 hearing to speak only in general terms, has created considerable ambiguity in the record, and the above statement of facts is therefore necessarily vague. However, it appears that the particular point about which Wells Fargo interjected related to whether "the increase in Boreal's interest rate was linked to a payment to NYSEG." *A.T. Reynolds,* 424 B.R. at 80.

After the side session, the Mediator informed the Bankruptcy Court that one of the parties was not participating in good faith. (12/31 Tr. 143.) The mediation then reconvened, and Wells Fargo made a settlement offer that was deemed "unacceptable" by the parties. *In re A.T. Reynolds & Sons, Inc.,* 424 B.R. 76, 80 (Bankr.S.D.N.Y.2010). This offer "came after McAuliffe and Zwerman spent an extended period on the phone with an unidentified person, out of the presence of the mediator." *A.T. Reynolds,* 424 B.R. at 80–81. ***379** McAuliffe states that during this call he "discuss[ed] the severity of the allegations with [his] colleagues." (McAuliffe Aff. 4 n.2.)

Wells Fargo does not dispute this basic chronology but characterizes events differently. Zwerman maintains that Wells Fargo approached the mediation with an open mind, intending to "listen to the parties that were attending the mediation, see what relevant facts were going to be brought up, [and] to make a decision one way or the other." (12/31 Tr. 34.) According to Zwerman, he and McAuliffe considered Wells Fargo's exposure to risk, and their "conclusion was that ... what was presented to us did not make sense and that our exposure was zero...." (12/31 Tr. 43.) McAuliffe denies interrupting Boreal's counsel during the mediation. (12/31 Tr. 34.)

Based on the above events, the mediator submitted a report to the Bankruptcy Court detailing the allegations of bad faith, including the following:

> 3. When supplied with ... a statement [of legal issues] by counsel to [A.T. Reynolds], Wells Fargo objected to language to the effect that the mediation might cover "any other issues anyone wants to discuss, of course";
>
> 4. Wells Fargo demanded to know the identities of the individuals who would attend the mediation;
>
> 5. Wells Fargo expressed concern that if its demands were not complied with, then the mediation would be a "free for all" which would "waste everybody's time";
>
> ....
>
> 7. McAuliffe attended the mediation "prepared only to repeat a pre-conceived mantra that indicated that Wells

> Fargo was not open to any compromise that would involve 'taking a single dollar out of their pocket' ";
>
> 8. The Mediator's attempts to see if there was any credibility to the concept that the increase in Boreal's interest rate was linked to a payment to NYSEG were deflected by McAuliffe's repeating his mantra;
>
> ....
>
> 10. Wells Fargo's only offer came after the hearing in which the Court stated the consequences of bad faith, and such offer was "unacceptable" to the other parties; and
>
> 11. The offer came after McAuliffe and Zwerman spent "an extended period on the phone with an unidentified person, out of the presence of the mediator."

A.T. Reynolds, 424 B.R. at 76.

The Mediator made no findings regarding Zwerman's authority to settle the case. Based on the Mediator's report, the Bankruptcy Court *sua sponte* ordered that Wells Fargo show cause why it should not be sanctioned for failure to comply with the Mediation Order. (Docket No. 231.) That Order precipitated a voluminous submission from Wells Fargo and a contentious evidentiary hearing on December 31, 2009 that drew all of the participants in the mediation into its vortex.

IV. *The Bankruptcy Court's Decision*

Based on the foregoing, the Bankruptcy Court found that Wells Fargo had failed to participate in the mediation in good faith. As an initial matter, the Bankruptcy Court held that:

> Passive attendance at mediation cannot be found to satisfy the meaning of participation in mediation, because mediation requires listening, discussion and analysis among the parties and their counsel. Adherence to a predetermined resolution, without further discussion or other participation, is irreconcilable with *risk analysis,* a fundamental practice in ***380** mediation.... [T]his Court has authority to order the parties to participate in the process of mediation, which entails discussion and risk analysis.

A.T. Reynolds, 424 B.R. at 85–86 (emphasis added). Accordingly, the Bankruptcy Court held that "attendance without participation in the discussion and risk analysis ... constitutes failure to participate in good faith." *A.T. Reynolds,* 424 B.R. at 89.

In the Bankruptcy Court's view, Wells Fargo exhibited bad faith for three reasons. First, it failed to participate in the process of mediation meaningfully because it "insisted on being dissuaded of the supremacy of its legal obligation, in lieu of participating in discussion and risk analysis." *A.T. Reynolds,* 424 B.R. at 91. Of particular concern was the fact that "Wells Fargo would not discuss whether there was any link between two substantive events in the case, and ... its counsel squashed any potential legal debate by interrupting counsel to Boreal when he attempted to discuss such a link." *A.T. Reynolds,* 424 B.R. at 91.

Second, the Bankruptcy Court found that Zwerman did not have authority to settle the matter because (i) he only had authority to settle for a "predetermined amount," despite the "very real possibility that the amount in controversy might have turned out to be in excess of $35,000"; (ii) he was only prepared to discuss predetermined legal issues; (iii) he did not "appear to have had the authority to enter into creative solutions that might have been brokered by the Mediator"; and (iv) "a pivotal decision was made by an absent person." *A.T. Reynolds,* 424 B.R. at 93–94.

Third, the Bankruptcy Court found that Wells Fargo "sought to control the procedural aspects of the mediation by resisting filing a mediation statement and demanding to know the identities of the other party representatives." *A.T. Reynolds,* 424 B.R. at 92.

Based on these findings, the Bankruptcy Court sanctioned Wells Fargo and Ruskin pursuant to Fed.R.Civ.P. 16(f) and held them in contempt for violation of the terms of the Mediation Order.

DISCUSSION

I. *Legal Standard*

[1] [2] [3] [4] Fed.R.Civ.P. 16(f) provides that a court may sanction a party or its attorney for failure to obey a pretrial order of the Court. A bankruptcy court's award of sanctions may be set aside only for abuse of discretion. *In re Kalikow,* 602 F.3d 82, 91 (2d Cir.2010). A court abuses its discretion "if it based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence." *Kalikow,* 602 F.3d at 91. "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *Zervos v. Verizon N.Y., Inc.,* 252 F.3d 163, 168 (2d Cir.2001). A court also abuses its discretion "if its decision—though not necessarily the product of a legal error or a clearly erroneous factual finding—cannot be located within the range of permissible decisions." *Zervos,* 252 F.3d at 169.

[5] While contempt orders are also reviewed for abuse of discretion, "review of a contempt order is more exacting than under the ordinary abuse-of-discretion standard because a [bankruptcy] court's contempt power is narrowly circumscribed." *Perez v. Danbury Hosp.,* 347 F.3d 419, 423 (2d Cir.2003).

***381** II. *Sanctions*

A. *Good Faith Participation in Court–Ordered Mediation*

Mediation is typically a voluntary process. In a mandatory court-ordered mediation, however, adversary parties are forced to participate in a collaborative process that one or both parties may not desire. As a result, some states and commentators have adopted or proposed a requirement that parties to a mandatory mediation participate in "good faith." *See generally* John Lande, *Using Dispute System Design Methods to Promote Good–Faith Participation in Court–Connected Mediation Programs,* 50 UCLA L. Rev. 69 (2002). Courts have not developed any clear standards for evaluating good faith in court-ordered mediation. Nevertheless, "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." Lande, 50 UCLA L. Rev. at 84; *see also Seidel v. Bradberry,* 94 Civ. 0147, 1998 WL 386161, at *3 (N.D.Tex. July 7, 1998) (imposing sanctions for failing to attend a court-ordered mediation); *Nick v. Morgan's Foods, Inc.,* 270 F.3d 590, 597 (8th Cir.2001) (imposing sanctions for, *inter alia,* failing to submit a pre-mediation memorandum); *Francis v. Women's Obstetrics & Gynecology Grp., P.C.,* 144 F.R.D. 646, 648 (W.D.N.Y.1992) (same).

Advocates of a good faith standard argue that it forces adversary parties to take the mediation seriously, and avoids the risk of "pro forma" mediation where parties participate only to the minimal extent necessary to fulfill the court's requirements. *See* Kimberlee K. Kovach, *Good Faith in Mediation,* 38 S. Tex. L. Rev. 575, 595 (1996). On the other hand, a good faith standard poses several problems. First, "[g]ood faith is an intangible and abstract quality with no technical meaning or statutory definition...." Black's Law Dictionary (5th ed. 1979). Of further concern is the tension between inquiring into good faith while preserving the confidential nature of a mediation. Kovach, 38 S. Tex. L. Rev. at 601; Edward F. Sherman, *Court–Mandated Alternative Dispute Resolution: What Form of Participation Should be Required,* 46 SMU L. Rev. 2079, 2093 (1993). Participants —including the mediator—are typically prohibited from divulging statements made during the course of the mediation. *See Procedures Governing Mediation,* General Order M–390 § 5.1. Yet if allegations of bad faith arise, a court must investigate those allegations, endangering the mediation's confidentiality. Kovach, 38 S. Tex. L. Rev. at 601; Edward F. Sherman, *Court–Mandated Alternative Dispute Resolution: What Form of Participation Should be Required?,* 46 SMU L. Rev. 2079, 2093 (1993). Finally, inquiry into the parties' conduct in a mediation, backed by the threat of sanctions, may exact a coercive influence on the parties to settle. *See* Sherman, 46 SMU L. Rev. at 2093. These considerations guide this Court's review of the proper scope of the good faith standard.

The Bankruptcy Court found that Wells Fargo failed to mediate in good faith because it (1) did not "participate" sufficiently in the process of mediation, which in the Bankruptcy Court's view entails "discussion" and "risk analysis"; (2) did not send a representative with settlement authority, and (3) attempted to control the procedural aspects of the mediation.

B. *"Participation" During Mediation Proceedings*

Most courts that have addressed allegations of insufficient "participation" during ***382** mediation proceedings (i.e., the degree to which a party discusses the issues, listens to opposing viewpoints, analyzes its risk of liability, and generally participates in the "process" of mediation)[2] have declined to find a lack of good faith. *See, e.g., Graham v. Baker,* 447 N.W.2d 397, 401 (Iowa 1989) (sanctions inappropriate despite the fact that party's behavior "ranged between acrimony and truculency [and] precluded any beneficial result to the parties from the mediation process"); *Stoehr v. Yost,* 765 N.E.2d 684, 687 (Ind.App.2002) (no bad faith despite allegation that party was unwilling to "really listen" to arguments of the opposing party). *But see Brooks v. Lincoln Nat. Life Ins. Co.,* No. 05 Civ. 118(WJR), 2006 WL 2487937, at *4 (D.Neb. Aug.25, 2006) (finding bad faith where party "(1) indicat[ed] [she] would not respond to the defendants' initial offer and direct [ed] the mediator to tell defendants they had five minutes to put a serious settlement offer on the table or [she] was leaving, (2) indicat[ed] defendants' second offer or proposal was unacceptable and unworthy of response, (3) [did] not allow[ ] the mediator to explain the defendants' offers, (4)[did] not engage[e] in dialogue with defendants' counsel to correct what [her] counsel perceived as deficiencies in the mediation process, and (5) unilaterally terminat[ed] or abandon[ed] the mediation process"). Still, these courts declined to elucidate a standard for good faith participation during mediation.

2 "Participation" in this regard is distinct from such objective criteria as attendance, exchange of pre-mediation memoranda, and settlement authority, which several courts have found to be elements of good faith in court-ordered mediation.

[6] **[7]** **[8]** In determining the appropriate scope of inquiry into good faith participation during mediation, this Court is guided by considerations of litigant autonomy and confidentiality in mediation proceedings. It is well-settled that a court cannot force a party to settle, nor may it invoke "pressure tactics" designed to coerce a settlement. *Kothe v. Smith,* 771 F.2d 667, 669 (2d Cir.1985). Moreover, in an analogous context, although a court may require parties to appear for a settlement conference, *see, e.g., Bulkmatic Transport Co. v. Pappas,* 99 Civ. 12070(RMB)(JCF), 2002 WL 975625, at *2 (S.D.N.Y. May 9, 2002), it may not coerce a party into making an offer to settle. *See Dawson v. United States,* 68 F.3d 886, 897 (5th Cir.1995) ("[T]here is no meaningful difference between coercion of an offer and coercion of a settlement: if a party is forced to make a settlement offer because of threat of sanctions, and the offer is accepted, a settlement has been achieved through coercion."). And a party is within its rights to adopt a "no-pay" position. *Negron v. Woodhull Hosp.,* 173 Fed.Appx. 77, 79 (2d Cir.2006) (party was "free to adopt a 'no pay' position" at a court-ordered mediation).

[9] Thus, contrary to the Bankruptcy Court's determination, Wells Fargo was within its rights to enter the mediation with the position that it would not make a settlement offer. It was also within its rights to "predetermine [ ] that it was not liable" and to "insist[ ] on being dissuaded of the supremacy of its legal position." *A.T. Reynolds,* 424 B.R. at 92. A contrary holding would be directly at odds with a party's right to adopt a "no pay" position in settlement negotiations.[3]

3 Indeed, rather than being hostile to mediation, "dissuasion" is in fact the core of the process, particularly in a mandatory mediation where the parties are participating only by reason of a court order. It should be presumed that each party enters a mediation confident in the strength of its legal position, and a settlement will result only if the mediator is able to persuade both parties to meet somewhere in between.

***383** **[10]** **[11]** Although parties to a mediation must listen courteously to opposing arguments and respond in kind, ultimately the benefits of enforcing such participation by threat of sanctions are dwarfed by the significant potential for harm. Where parties do not want to settle, inquiry into a minimal level of participation (beyond objective criteria such as attendance, exchange of pre-mediation memoranda, and settlement authority) backed by threat of sanctions forces unwilling parties to engage each other civilly to satisfy a court order. But ultimately, mediation will only succeed if the parties themselves want it to, and a court's order to mediate—even in good faith—will not change the mind of party who believes that settlement is not in their best interest. Certain disputes are simply not amenable to mediation, and it should not be a surprise when attempts to mediate them quickly deteriorate. Such a case exists where, as here, there exists a strongly contested threshold factual issue—the source of the Utility Payment—that may be fully determinative of a party's liability.

This Court does not share the Bankruptcy Court's view that the standard for determining participation is "risk analysis." Risk analysis is often an internal process, and it is difficult—if not impossible—to distinguish between a party that refuses to consider a given risk from a party that analyzes the risk and determines that the risk is zero. Indeed, this is precisely the rationale given by Wells Fargo. Zwerman testified that "[o]ur conclusion was that ... what was presented to us did not make sense and that our exposure [to risk] was zero...." (Tr. 43.) Thus, Wells Fargo did not forego risk analysis merely because it determined that it was not liable and adhered to this position at the mediation; such conduct is entirely consistent with a rational analysis of risk.

Inquiring into the parties' level of participation also imperils the confidentiality of mediation. This is illustrated by the present dispute. Throughout the sanctions hearing, the Bankruptcy Court was forced to determine the facts relevant to participation while shielding itself from the confidential aspects of the proceedings. The Bankruptcy Court consistently admonished the witnesses to refrain from discussing specific details of the mediation. (*See, e.g.,* 12/31 Tr. 55 ("Please try to stay general. I don't want to be tainted...."); 12/31 Tr. 59 ("Let's not go into the mediation. This is a risk analysis. All Mr. Goldman was doing was risk analysis.... [L]et's go general here. He didn't agree with the risk analysis.... [T]hat's what you want to be saying"); 12/31 Tr. 83 ("I want you to emphasize and talk to me about the mediation process, not the offers, not what's going on, but the mediation process.").) But ultimately, confidential information was communicated to the Court. (*See* 12/31 Tr. 100 ("Do not again talk ... about the dollar value. Even though I have now sort of become of aware of this stuff, I'm trying my best not ... to be.").) Moreover, the necessary exclusion of confidential information from the hearing had the unintended—but unavoidable—effect of excluding relevant facts, such as the specific issues discussed at the mediation and the parties' legal and factual positions. (*See* 12/31 Tr. 133–34).

Accordingly, this Court holds the confidentiality considerations preclude a court from inquiring into the level of a party's participation in mandatory court-ordered mediation, i.e., the extent to which a party discusses the issues, listens to opposing ***384** viewpoints and analyzes its liability.[4] This holding provides a clear and objective standard with minimal intrusion into confidentiality and a party's right to refuse to settle. This holding is also consistent with the general pattern of interpretation by the courts, which "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." Lande, 50 UCLA L. Rev. at 84. Accordingly, the Bankruptcy Court's determination that Wells Fargo did not "participate" in the mediation in good faith was clearly erroneous.

4 This does not mean that *all* conduct in a mandatory mediation is outside the scope of a court's inquiry into good faith. Where, for example, a party demonstrates dishonesty, intent to defraud, or some other improper purpose, the benefits of inquiry into such conduct may outweigh considerations of coercion and confidentiality. But no such allegations have been presented here and, accordingly, this Court does not reach this issue.

C. *Settlement Authority*

[12] The Bankruptcy Court also found that Wells Fargo failed to send a representative with sufficient settlement authority. Several courts have found that a failure to send a representative with settlement authority to a mediation illustrates a lack of good faith warranting sanctions. *See, e.g., Nick,* 270 F.3d at 597; *Raad v. Wal–Mart Stores, Inc.,* 97 Civ. 3015(JK), 1998 WL 272879, at *1 (D.Neb. May 6, 1998). This Court agrees that such conduct may constitute a lack of good faith.

[13] Here, however, in requiring Zwerman to have had the ability to (1) settle this case for *any* amount, including an amount greater than the amount in controversy; (2) discuss *any* theory of legal liability; and (3) enter into undefined "creative solutions," the Bankruptcy Court applied an unworkable and overly stringent standard for determining "settlement authority" and accordingly abused its discretion. Settlement figures are generally no more than the amount in controversy, and there is rarely a need for a party attending a mediation to have authority to settle for greater than that amount. It is also unreasonable to expect a party to be prepared to discuss *every* possible legal theory, including those about which it had no prior notice. Finally, large corporations operate under divisions of labor and authority, and a given "creative solution" may require approval of any number of corporate officers. A corporation cannot reasonably be expected to anticipate the virtually limitless range of

"creative solutions" that might be raised at mediation. The Bankruptcy Court's standard would require attendance by a corporate officer with a degree of responsibility and control that rarely exists in a single individual.

Thus, where a mediation order requires the presence of a person with "settlement authority," a party satisfies this requirement by sending a person with authority to settle for the anticipated amount in controversy and who is prepared to negotiate all issues that can be reasonably expected to arise. Here, it is undisputed that Zwerman had the authority to settle for up to the full amount in controversy. In addition, McAuliffe was prepared to advise Zwerman regarding the legal issues suggested by A.T. Reynolds as subject to discussion—a reasonable guidepost for the issues that are likely to arise. Finally, the Bankruptcy Court's finding that "a pivotal decision was made by an absent person" was clearly erroneous. The record is unambiguous that Zwerman had full authority to settle the matter. The notion that Zwerman needed to call the Wells Fargo ***385** corporate office in order to obtain permission to offer the settlement is conjecture.

Accordingly, the Bankruptcy Court's finding that Zwerman did not have "settlement authority" was clearly erroneous.

D. *Control of the Procedural Aspects of the Mediation*

[14] Finally, the Bankruptcy Court's finding that Wells Fargo attempted to "control the procedural aspects of the mediation" was also clearly erroneous. Wells Fargo ultimately submitted a mediation statement and attended the mediation, as required by the order. The issues raised by Wells Fargo in pre-mediation exchanges with the Mediator were legitimate points of concern regarding the issues to be raised in the mediation and the other parties' participation in the proceeding. There is nothing in the General Mediation Order preventing parties from raising such valid concerns.

Accordingly, The Bankruptcy Court's sanctions order was an abuse of discretion and is reversed.

III. *Contempt*

To hold a party in civil contempt, a court must find that (1) the order the party failed to comply with is clear and unambiguous, (2) the proof of noncompliance is clear and convincing, and (3) the party has not diligently attempted to comply in a reasonable manner. *King v. Allied Vision. Ltd.,* 65 F.3d 1051, 1058 (2d Cir.1995). As discussed above, the Bankruptcy Court's finding that Wells Fargo violated the terms of the Mediation Order was clearly erroneous. Accordingly, the Bankruptcy Court's contempt order was an abuse of discretion and is reversed.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's Order imposing sanctions and holding Appellant Wells Fargo in contempt is reversed.

SO ORDERED.

All Citations

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End of Document

- Owner, developer and operator of mixed-use property building
- Located in high-end and sought-after downtown Raleigh neighborhood
- Petition date value of property: $15,340,000.00
- Secured claims per Schedule D: $12,323,658.45
- Unsecured claims per Schedule F*: $42,266.80
- Four judges involved in case
- Debtor's 51% equity owner issued guaranty of Debtor's most significant loan

**As amended*

BURCAM CAPITAL II, LLC

Case No. 12-04729-8-SWH

CWCAPITAL MANAGEMENT LLC ("CWC")

- Only significant secured creditor in case*
- Special servicer of two notes** in which proofs of claim were filed in amounts of approximately $14,000,000.00 and $1,000,000.00
- August 2011: Debtor defaulted on payment
- November 2011: CWC exercised option to accelerate loans and demanded Debtor to pay all amounts due and outstanding
- CWC attempted to foreclose on property when Debtor failed to pay all amounts due
  - Debtor's bankruptcy petition filed 20 minutes prior to scheduled foreclosure sale
- Purchased claims of roughly 16 general unsecured creditors
  - Controlled voting in each class in Debtor's first proposed plan, and thus, controlled confirmation

**Other than a tax lien.*
***Held by U.S. Bank, N.A., and Bank of America, N.A., respectively.*

CONTENTIOUS NATURE OF CASE

- 30+ responses and/or objections filed by CWC
- 5+ motions filed by CWC
  - *To designate as single asset real estate case; for Rule 2004 examination; to dismiss case; to stay pending appeal of confirmation order; to object to continued use of cash collateral and move for adequate protection*
- 1 appeal filed by CWC → *confirmation of Debtor's chapter 11 plan*
- 3 competing plans filed by CWC → *all liquidating*
- CWC's purchase of roughly 16 claims → *to block confirmation*
  - CWC held overwhelming number and dollar amount of claims
  - Asserted ability to block confirmation as a basis for motion to dismiss case

CONTENTIOUS NATURE OF CASE, *CONT'D*

- Evidence CWC pressured appraisers to lower property appraisals
- CWC allegedly obstructed discovery of third parties
- Two adversary proceedings filed by Debtor against CWC (one against U.S. Bank and one against Bank of America):
  - *Asserted claims for: (1) breach of contract/breach of covenant of good faith and fair dealing; (2) unfair and deceptive trade practices; (3) libel; (4) interference with contract; (5) declaratory judgment on invalidity of loan documents and chain of title; (6) inequitable conduct and request for equitable relief and equitable subordination; (7) accounting; and (8) objection to claim.*

CONFIRMATION BATTLES – *SETTING THE STAGE*

Debtor's First Plan

- Provided for 100% payout
- CWC's purchase of claims allowed it to block confirmation, which led to…

CONFIRMATION BATTLES – *SETTING THE STAGE*

Debtor's Second Plan

- Created separate class for claims purchased by CWC
  - Created impaired accepting class
- Confirmed!
  - Bankruptcy court: Debtor had legitimate business reason for separately classifying claims
- …but then reversed on appeal
  - District court: No legitimate business reason; product of gerrymandering
- …and appealed by Debtor to Fourth Circuit

CONFIRMATION BATTLES – *SETTING THE STAGE*

Other Plans on Remand

- CWC: 3 plans → all liquidating
- Debtor: one new plan
  - All general unsecured claims treated in one class
  - 100% payout

IMPACTS OF REVERSAL ON CONFIRMATION

- Value of Collateral
  - Determined as of confirmation date → new evidence permitted
  - Later date of confirmation + booming area for growth → increasing property value
- Potential for Redefining Class
  - Debtor's motion to designate ballots pursuant to 11 U.S.C. § 1126(e)
  - Opportunity to come up with new legitimate business justifications for separately classifying – i.e., the existence of different incentives among creditors
- Offer to Purchase
  - CWC filed Notice of Offer to Purchase Property for $17,810,000.00
  - Offer to purchase made by Blue Ridge Realty, Inc.
  - CWC consented to sale

MEDIATED SETTLEMENT CONFERENCE

CWC faced:

- Increasing value of its collateral →
  - Offer price to purchase property being less desirable
  - Debtor's ability to bifurcate CWC's claims
- Debtor's motion to designate ballots and discovery thereon
- Potential new plan of reorganization with acceptable justification for separate classes
- Order prohibiting CWC from credit bidding

MEDIATED SETTLEMENT CONFERENCE

Debtor faced:

- Inability to propose plan satisfactory to CWC
- Competing liquidation plans filed by CWC
  - Proposed sale of property; dissolution of business
- Interim attempts by CWC seeking adequate protection and/or payment
- CWC's crash and burn strategy

Both faced:

- Potential unfavorable ruling from Fourth Circuit

SETTLEMENT

- Payment of CWC's claim within 180 days
- Reduction of CWC's claim amount to $13,900,000.00
- Sale of one member of Debtor's equity interest to other member
- Release of all claims, including those against guarantor

Shotwell Landfill, Inc.

"DEBTOR"

CASE NO. 13-02590-8-SWH

Shotwell Landfill, Inc. – "Debtor"

- Owner of multiple business entities in landfill operations
- Voluntary petition under chapter 11 filed April 2013
- Case administratively consolidated with filings of related entities
  - Shotwell Transfer Station II, Inc.
  - Capitol Waste Transfer, LLC
  - Capitol Recycling, LLC
  - King's Grading, Inc.
  - Debris Removal Partners, LLC
- Secured debt guaranteed by sole owner of Debtor

LSCG Fund 18, LLC – Secured Creditor

- Successor in interest to primary lender, BB&T, in September 2013
- Held majority value of secured claims
- Two months after acquiring interest, filed motion to appoint trustee
- Held nearly $15,000,000 in total claims (secured and unsecured)

Nature of Dispute

- LSCG began taking action promptly upon purchase of BB&T's interest:
  - Emergency motion to appoint trustee → Oct. 31, 2013
  - Motion for relief from stay to foreclose on landfill → Nov. 27, 2013
- December 2013 – first attempt at mediation
- January 2014 – impasse

Post-Mediation: Conflict and Growth of Risk

- February 2014 → Debtor files amended plan
  - Consolidated plan for all debtors
  - Paid LSCG entirely within 7 years
- LSCG and Unsecured Creditors Committee object to amended plan
- Second motion to appoint trustee
  - Allegations of gross mismanagement by Debtor
- May 2014 → LSCG files competing liquidating plan
- June 2014 → court appoints CRO
- June 2014 – October 2014 → LSCG files **6 amended plans**

Approaching Mediation, Round Two

- Oct. 16, 2014 → Closing arguments on competing plans
- Parties suggest possibility of mediation while court took competing plans under advisement
  - Debtors and CRO requested mediation in open court
- Hesitancy of mediation
  - Pending interlocutory appeal in EDNC on the denial of motion to appoint trustee
  - Did not want to slow down court's ability to review competing plans
- Ordered mediation be completed by Nov. 26, 2014

Mediated Settlement Conference

- Factors impacting momentum of settlement:
  - Large amount of costly litigation going forward
  - Risk of court choosing one party's plan over the other's
  - Reluctance of court to schedule simultaneous confirmation hearings on competing plans
  - Mediation fees nominal compared to fees already incurred and prospective fees in further litigation
- Attending parties:
  - Bankruptcy Administrator
  - Lead Debtor
  - LSCG
  - Guarantor

Settlement

- Reached agreement on Nov. 10 and 11 during mediation
- LSCG reduced amount owed from $16.7 million to $15.25 million
  - Monthly payments + $575,000 payment made within one year
- CRO to remain in place until LSCG paid in full
- LSCG withdrew appeal of order denying motion to appoint trustee
- Parties dismissed all claims in state court
- August 2015 → Debtor's plan confirmed
  - Providing for treatment of LSCG according to settlement agreement