MEDIATION IN BANKRUPTCY CASES

Panel Presentation By:

Jeffrey R. Ansel, Winthrop & Weinstine, P.A.

Lara O. Glaesman, Stinson Leonard Street

James A. Rubenstein, Moss & Barnett

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I. TYPICAL DISPUTES IN BANKRUPTCY CASES

Depending on the type of bankruptcy case you are involved in, the case may include any of the following parties: (i) debtor; (ii) debtor-in-possession; (iii) secured creditors; (iv) unsecured creditors; (v) unsecured creditors committee; (vi) other committees (of creditors or equity security holders); (vii) U.S. Trustee; (viii) case trustees (Chapters 7 & 11); (ix) standing trustees (Chapters 12 & 13); (x) potential purchaser(s) of assets; (xi) counter-parties to contracts and/or leases; (xii) equity interest holders; (xiii) other parties in interest; and (xiv) defendants in adversary cases.

In bankruptcy cases, disputes are resolved through contested matters (initiated by the filing of a motion or an application) and adversary proceedings (commenced by the filing of a separate lawsuit). The majority of bankruptcy disputes are settled through a consensual agreement reached between the parties, which generally are supported by the Bankruptcy Courts. While many attorneys involved in a bankruptcy case may suggest mediation in an effort to resolve a lawsuit (adversary proceeding), those same attorneys may not consider mediation as an option for resolving other bankruptcy disputes. This may be a lost opportunity because there are numerous facets of a bankruptcy case in which mediation may be useful in resolving disputes, including the types of disputes described below in more detail.

A. Avoidance Actions for the Recovery of Money or Property

Turnover of Property of the Bankruptcy Estate

- A trustee may bring into the estate property in which the debtor does not have a possessory interest in on the petition date in order to gather and manage all property of the estate
- All entities, other than custodians, that have possession or control of property of the estate that the trustee can use, sell or lease or that the debtor can exempt must be turned over to the trustee
- The trustee has the burden of proof, by a preponderance of the evidence

Preferential Transfers Under 11 U.S.C. § 547

- A trustee may avoid any transfer of an interest in the debtor in property to (or for the benefit of) a creditor, for an antecedent debt, made while the debtor was insolvent, on or within 90 days before the filing of the bankruptcy petition that enables the creditor to receive more than the creditor would have received in chapter 7

- Certain transactions meet the definition of a preference but will not be avoidable because the Bankruptcy Code provides certain exceptions to liability, including but not limited to: (i) transfers in the ordinary course of business, (ii) substantially contemporaneous exchange, (iii) a 3-day safe harbor for purchase money security interests, (iv) subsequent new value, (v) the granting of a perfected lien on inventory or accounts receivable, (vi) domestic obligations, (vii) and certain statutory liens

Fraudulent Transfers Under 11 U.S.C. § 547 or Minn. Stat. §§ 513.41–51

- A plaintiff may sue under theories of actual fraud, constructive fraud, or both

- To prove a transfer was made with actual fraud, the evidence must support a showing that the debtor made a transfer with the actual intent to hinder, delay, or defraud creditors and courts allow using circumstantial evidence (often referred to as "badges of fraud") to show fraud

- To prove a constructive fraud case, transfers may be avoided where an insolvent debtor made a transfer to another party for less than "a reasonably equal value"

B. Claims Scheduled by the Debtor and/or Creditors' Claims

Allowance of Claims and Objections to Claims

- The Bankruptcy Code defines a claim as the right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmeasured, disputed, undisputed, legal, equitable, secured, or unsecured

- The filing of a proof of claim constitutes "prima facie evidence of the validity and amount of the claim," which means if no objection to the claim is filed, the filing of the claim alone is sufficient to allow the creditor to share in the estate

- If an objection to a claim is filed, the burden then shifts to the objector to put on evidence sufficient to overcome the prima facie presumption

Administrative Expenses

- If you have the right to an administrative expense claim, you may get paid better and faster than most of the other claimants in the case

- To get your claim elevated to the high-priority administrative expense category, the court must conclude that you provided a benefit to the estate (actual necessary costs and expenses of preserving the estate)

Estimation of Claims for Plan Voting Purposes

- The Court has the power to estimate claims of creditors for purposes of allowance and for temporary allowance for purposes of voting on a plan of reorganization

- The Code and Rules are silent about the sufficiency of evidence and burden of proof necessary to estimate a claim

Secured/Unsecured Determination

- A secured claim allows for the repossession of the asset to secure at least a partial loan repayment and has a higher priority position in a bankruptcy case

- An unsecured claim is a claim which is not backed by any collateral and which the creditor has no assurance of payment if the debtor defaults on the debt payments

Rejection Damages/Cure Amounts for Unexpired Leases

- Rejection of an unexpired lease by the debtor gives rise to claims for damages by the lessor in addition to the administrative expense claims for post-bankruptcy rent and the damage claims are subject to special bankruptcy limitations

- Rejection of the lease is deemed to be a complete breach of the lease immediately prior to the bankruptcy case and the lessor's damage claims that result from rejection are treated as general unsecured claims

- The lessor has a claim for all unpaid rent due on the earlier of the date the bankruptcy case was commenced or the date the lessor recovered possession of the property

- The lessor also has a claim for future rent that would have been due had the lease not been rejected; however, this claim is capped by statute

Subordination of an Allowed Claim or Interest

- Subordination agreements are enforceable in bankruptcy cases
- The Court may subordinate all or part of a claim or interest on principles of equitable subordination

C. Bankruptcy Estate Assets

Scheduled/Unscheduled Assets

- The debtor is required to list all assets of the estate at the time of filing and a value for each of the assets

Determinations of Validity, Priority, or Extent of a Lien or Other Interest in Property

- Consensual liens, judicial liens, and status liens

D. Discharge

While there are all sorts of exceptions, for an individual debtor, if the debtor plays by the rules (i.e., files his schedules, discloses all his property, appears at the meeting of creditors, cooperates with the trustee, etc.), then at the end of the case, the debtor receives a discharge (his remaining liability on his unpaid debts is canceled).

Proceedings to Object to or Revoke a Debtor's Discharge

- The trustee, the United States trustee, or a creditor may object to a debtor's discharge and often, these types of cases involve various forms of alleged dishonesty on the part of the debtor

Proceedings to Determine the Dischargeability of a Debt

- The certain types of debts that are not dischargeable in a bankruptcy case depend upon the type of bankruptcy case filed
- For consumer bankruptcies, these are the most commonly filed type of adversary proceedings

E. Valuation

Cash Collateral Disputes

- Cash collateral is defined by the Bankruptcy Code as property "in which the estate and an entity other than the estate have an interest," and includes cash, negotiable instruments, documents of title, securities, deposit accounts, and other cash equivalents

- For debtors that have working capital financing, most or all of the debtor's cash is likely to be cash collateral and if the debtor wants to continue operating, it must negotiate a deal with the secured lender (by providing the lender with adequate protection) or find a new lender

Adequate Protection

- In numerous instances, the trustee or debtor in possession is prohibited from taking certain actions during the case unless it provides another party with adequate protection

- Adequate protection may be provided by: (i) cash payments, (ii) an additional or replacement lien, or (iii) such other relief that will result in the realization by the entity of the indubitable equivalent of the nondebtor's interest in the property

DIP Financing

- DIP financing is debtor-in-possession financing obtained during a commercial bankruptcy case

- This financing must be approved by the Court and often it is considered senior to all other debt, equity, and any other securities issued by the debtor

F. Treatment of Executory Contracts and Leases

Motions to Assume, Assume and Assign, or Reject Executory Contracts and Leases

- The debtor-in-possession or trustee has three options for dealing with unexpired contracts and real property leases: (i) rejection; (ii) assumption; or (iii) assumption and assignment to a third party

- Rejection constitutes a breach of the contract or lease by the debtor and assumption reinstates the contract or lease and makes it fully enforceable as between the parties

G. Plan Confirmation Process

Disclosure Statement and Plan Confirmation

- A debtor may not solicit acceptance of a plan without a court-approved disclosure statement containing adequate protection, which is "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records…that would enable…a hypothetical…investor…of the relevant class to make an informed judgment about the plan

- A creditor may object to the Disclosure Statement, Plan, or both my asserting that the plan is unconfirmable

II. CASE STUDIES

A. U.S. Bankruptcy Court, District of Minnesota

- *In re Archdiocese of Saint Paul and Minneapolis* (Case No. 15-30125)

- *In re Petters Company, Inc. et al.* (Case No. 08-45257)

B. U.S. Bankruptcy Court, District of New Jersey

- *In re Dotts, LLC, et al.* (Case No. 14-11016)

C. U.S. Bankruptcy Court, Southern District of New York

- *In re Eastman Kodak Company, et al.* (Case No. 12-10202)

D. U.S. Bankruptcy Court, Eastern District of Michigan, Southern Division)

- *In re Detroit, Michigan* (Case No. 13-53486)

Copies of mediation orders and other filings from these cases are attached to these materials.

III. CONSIDERATIONS FOR USING MEDIATION

A. What Mediation Can Do

Since the vast majority of lawsuits and contested matters settle, mediation processes may allow your client to: (i) privately resolve dispute; (ii) preserve relationships; (iii) communicate directly with opponent; and (iii) better understand risks and costs of opponent's case.

B. What Mediation Cannot Do

While mediation has become a preferred method to resolve disputes, it cannot: (i) establish legal precedent; (ii) deter future parties from bring similar claims; or (iii) provide for injunctive relief.

C. Barriers To Success In Mediation

Common barriers to reaching a resolution include: (i) requirement of Bankruptcy Court approval of the settlement and disclosure of settlement terms; (ii) numerous parties are involved; (iii) complex legal issues; (iv) one of the parties wants to pursue the litigation regardless of the expense.

IV. COURT RULES APPLICABLE TO MEDIATION

Once you and your client and your opponent(s) make the determination to participate in mediation, there are several things you will need to review and consider, including applicable court rules, selection of your mediator, preparing the Mediation Agreement, preparing for and participating in the mediation session and documenting your final agreement.

A. Minnesota

1. Minnesota Rule of Practice 114

The Minnesota General Rules of Practice provide for Alternative Dispute Resolution. Specifically, Rule 114, which states:

All civil cases are subject to Alternative Dispute Resolution (ADR) processes, except for those actions enumerated in Minnesota Statutes, section 484.76 and Rules 111.01 and 310.01 of these Rules.

Minn. Gen. R. Prac. 114.01. Rule 114 of the Minnesota General Rules of Practice can be found at https://www.revisor.mn.gov/court_rules/rule.php?name=gp-114.

2. U.S. District Court, District of Minnesota Local Rule 16.5

The United States District Court for this District has promulgated Local Rule 16.5, which provides, in part:

LR 16.5-Alternative Dispute Resolution and Mediated Settlement Conference

(a) Alternative Dispute Resolution

(1) Purpose. The court has devised and implemented an alternative dispute resolution program to encourage and promote the use of alternative dispute resolution in this district.

(2) Authorization. The court authorizes the use of alternative dispute resolution processes in all civil actions, including adversary proceedings in bankruptcy, except that the use of arbitration is authorized only as provided in 28 U.S.C. § 654.

D. Minn. LR 16.5(a).

3. U.S. Bankruptcy Court, District of Minnesota Proposed Local Rule 9019-2

As of February 18, 2015, the Local Rules of the Bankruptcy Court did not address mediation. A new rule 9019-2, entitled "Mediation" has been proposed. The proposed rule states:

The court may refer any adversary proceeding or contested matter for mediation by any other federal judge. The court may refer the adversary proceeding or contested matter to any mediator chosen by the parties.

The comment period for this proposed rule expired on February 15, 2015, so the rule, or some variation of it, may be adopted in the near future. Even before this rule was proposed, parties can and do mediate in this Bankruptcy Court District.

Parties that seek mediation simply must request it from the court. (Request may be made by letter or stipulation.) Upon the making of a request, the court will issue an order referring the disputed matter for mediation (*see* samples attached), and appointing a mediator. The mediator may be another Bankruptcy Judge or a private

mediator. The proposed rule on mediation would not necessarily change this practice, although it does allow the court to refer a matter to mediation without the need for a request by the parties.

After appointment, the judicial mediator typically issues an order for mediation, which may or may not provide for the scheduling of the mediation, the submission of a mediation statement or statement of position, the confidentiality of the mediation, and the attendance of participants at the mediation.

Judicial Mediation vs. Private Mediation

The Bankruptcy Judges in this District mediate disputes arising in cases in which they are not involved. There are divergent opinions on the effectiveness and desirability of judicial mediation. Critics of judicial mediation focus primarily on the differing skill sets of judges and mediators. Judicial mediation also raises concerns about:

- confidentiality (will the mediating judge inadvertently disclose details of the mediation to the presiding judge?);
- waste of judicial resources (particularly given the demands on the judiciary and the multitude of private mediators);
- settlement pressure (which undermines the voluntary nature of mediation); and
- future cases and mediations for other clients.

But judicial mediation may in fact have a higher success rate because judges may be in a better position to inspire confidence in the process and to encourage cooperation and a willingness to resolve disputes. Importantly, the Bankruptcy Judges bring specialized knowledge and a perspective that private mediators lack. In addition, judicial mediation is "free" to the participants (much like a magistrate judge facilitated settlement conference), while private mediation is not free, and depending on who is participating in the mediation, there may be issues regarding how and how much the mediator gets paid.

B. U.S. Bankruptcy Court, Southern District of New York

The New York Mediation Procedures provide that "any adversary proceeding, contested matter or other dispute may be referred by the Court to mediation." Specifically, the Court can assign a matter to mediation *sua*

sponte, any party in interest or the U.S. Trustee can make a motion seeking mediation, or the parties can stipulate to mediation. (A copy of the New York Mediation Procedures is attached to these materials.)

The Clerk maintains a Mediation Register, from which mediators (who meet certain minimum qualifications) are selected and then appointed by the Court. If parties cannot choose a mediator, the Court will appoint one. In large Chapter 11 cases, the Court will enter a mediation order, which lists the mediator(s) selected for a particular case.

The New York Mediation Procedures provide for: (i) the fixing of the time and place of the mediation by the mediator; (ii) attendance at the mediation conference; (iii) post-mediation procedures (the mediator's final report and a stipulated order of judgment or a joint motion for approval of compromise if agreement is reached); (iv) compensation of mediator; and (v) confidentiality.

C. U.S. Bankruptcy Court, District of Delaware

Pursuant to Local Rule 9019-5(a), the Court may assign to mediation "any dispute arising in an adversary proceeding, contested matter or otherwise in a bankruptcy case." The Local Rules require mediation in all adversary cases filed in a Chapter 11 case and, in all other cases, adversary proceedings that include a preference claim. The Court can withdraw a matter from mediation at any time. The Clerk maintains a "Register of Mediators," from which mediators are selected (unless parties agree to select a mediator who is not on the Register). (A copy of Local Rule 9019-5 is attached to these materials.)

The Delaware Local Rules provide for: (i) the fixing of the time and place of the mediation by the mediator; (iii) the submission of materials to the mediator; (iii) attendance at the mediation conference; (iv) confidentiality of mediation; (v) post-mediation procedures (the filing of a certificate by the mediator and, if a mediation settlement is reached, a Notice of Settlement or a motion and proposed order seeking approval of the settlement); and (vi) compensation of the mediator.

V. SELECTION OF THE NEUTRAL

A. The Qualified Neutral

A "qualified neutral" in Minnesota is an individual or organization included on the State Court Administrator's roster as provided in Minnesota General Rule of Practice 114.12, who completed the training and continuing

education requirements specified in Minnesota General Rule of Practice 114.13. Other jurisdictions may have adopted similar or different standards for achieving the designation of "qualified neutral." There is no requirement that a mediator selected by the parties in a contested matter in Minnesota Bankruptcy Court be a Bankruptcy Judge or a "qualified neutral".

B. Selecting the Mediator

The mediator selected should be perceived by the parties as possessing sufficient amounts of the most relevant traits in a given dispute to allow the parties to approach the mediation with at least some optimism that a mutually acceptable solution can be achieved. Often, identifying a capable mediator is accomplished by recommendation and referral. An effective mediator is: (i) objective; (ii) an effective listener; (iii) forceful and persuasive; (iv) intelligent, flexible, articulate, empathetic and imaginative; (v) trustworthy; and (vi) patient.

There is some debate as to whether or not bankruptcy experience is a prerequisite to being a mediator in a bankruptcy case. The panelists believe it is often essential for the mediator to possess bankruptcy knowledge and experience, although the amount of bankruptcy knowledge and experience that a mediator should possess depends upon the nature of the dispute. If the mediator has bankruptcy knowledge and experience, it likely will enhance the mediator's credibility and ability to develop the parties' common interests resulting in a greater possibility of resolution.

C. Employment of the Mediator Approved by the Bankruptcy Court

If one of the parties participating in the mediation is the debtor-in-possession or the trustee, and the cost of the mediator is being shared among the parties, the debtor-in-possession or the trustee may need to have the mediator's employment approved by the Bankruptcy Court under Sections 327 or 328 of the Bankruptcy Code and the mediator may be required to submit a fee application in order to be paid from estate funds.

VI. THE MEDIATION

A. Premediation Communications

1. The Mediation Agreement

The Mediation Agreement governs the rules for the mediation process and the mediation sessions; identifies the parties, the dispute and the mediator selected; and addresses important matters

concerning the mediation sessions and the mediation process. Specifically, the Mediation Agreement should include provisions related to: (i) attendance; (ii) confidentiality; (iii) fees and costs; and (iv) mediator privilege. (A sample Mediation Agreement is attached to these materials.)

- Confidentiality Federal Rule of Evidence 408 protects offers of compromise and the admissibility of evidence, but not its discoverability. While evidence disclosed in mediation may be inadmissible, the bankruptcy rules encourage broad discovery rights through Rule 2004 and Rule 7026. A well-crafted interrogatory or deposition question could elicit the same information which was thought to have been disclosed in confidence during a mediation. Therefore, the mediation order or stipulation must include a provision to expressly protect confidentiality. If no order is obtained, or the order does not expressly protect confidentiality, then the mediation agreement itself must contain a provision providing that protection.

- Inadmissibility Although Rule 114.08(b) of the Minnesota General Rules of Practice provides that no statements made nor documents produced in non-binding ADR processes which are not otherwise discoverable shall be subject to discovery or other disclosure, the Mediation Agreement should contain a provision providing that protection.

- Mediator Privilege Although Rule 114.08(e) of the Minnesota General Rules of Practice provides that notes, records and recollections of the neutral are confidential, unless the parties and the neutral agree to such disclosure or a disclosure is required by law, the Mediation Agreement should address mediator privilege or confidentiality

- Attendance In a bankruptcy case, it is possible that a creditor or a creditors committee, may seek to participate in the mediation. A Bankruptcy Court has authority under the Bankruptcy Rules and the Bankruptcy Code to limit participation in mediation to preserve the confidentiality of such proceedings. See, 11 U.S.C. §§ 105, 107 and Rule 9018.

2. Scheduling Conference

Shortly after finalizing the Mediation Agreement, the mediator will usually arrange for an initial session (usually via letter or telephone) with counsel to address scheduling and other administrative and procedural matters, such as: (i) location of mediation; (ii) length and number of mediation sessions; (iii) required attendees; and (iv) format for mediation session(s).

3. The Mediation Statement

Prior to the mediation session, the mediator will usually require all parties to submit a written statement, prepared by counsel, providing the mediator with relevant information about the case. This is your opportunity to market your case to the mediator prior to the mediation session.

The Mediation Statement will provide the mediator with relevant facts/transactional documents, analysis of legal issues, a calculation of damages and an explanation of your client's position. While it can be thought to be similar to a Trial Brief or Summary Judgment motion, the mediator is not the party deciding your case. The purpose of your mediation statement is not to demonstrate that your client is 'right,' but that you have the better case.

The level of detail provided in the mediation statement will be determined by the complexity of the dispute, and often by the mediator. Some mediators are bankruptcy practitioners and familiar with the legal issues and only will need the relevant facts and transactional documents. Other mediators will require that they are provided with a fully cited legal analysis. Some mediators will want to be provided copies of your relevant cases, and will have read them and done their own legal research prior to the mediation. Other mediators will focus more on the parties and discovering their true needs, and less on the legal position and which party is 'right', using their inter-personal and negotiation skills to move the parties to an agreement.

Mediation Statements may or may not be shared among the parties. Typically, the mediation statement is provided to the mediator only, and is not shared with the opposing parties and as such, are confidential.

B. The Mediation Session

1. The General Session

(a) Opening Statements

The mediator may or may not permit opening statements to be made. Sometimes the mediator will require the opening statements be given by your client, not by the attorney. The focus is of the opening statement is to: (i) convey information about goals and the desired outcome of the mediation; (ii) an opportunity to address your opponent directly; and (iii) express a desire to resolve the dispute.

(b) Manage client communications

In all sessions, make sure you control communications with both the mediator and your opponent to better ensure that statements made by your client are not inconsistent with your goals.

2. Separate Caucuses

A mediator may separate the parties at any time during a mediation session (called separate caucusing) in order to inquire about what outcome your client wants, explain the weaknesses of your client's position and the strengths of the opposing party's position, and persuade your client to move toward settlement.

C. Settlement Agreement

If the mediation is successful, the parties should be prepared to enter into a written agreement, in the form of a term sheet or settlement agreement, before the end of the mediation session. This agreement is rarely the complete and final document, and is usually subject to final documentation and court approval. It is important to note that in a bankruptcy case, the settlement generally cannot be kept confidential because the Bankruptcy Rules require that a settlement must be approved by the bankruptcy court after notice to creditors.

VII. REFERENCES

A. Sample Orders Referring Matters For Mediation and Related Filings

B. U.S. Bankruptcy Court, Southern District of New York Mediation Procedures

C. U.S. Bankruptcy Court, District of Delaware Local Rule 9019-5

D. Sample Mediation Agreement