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MEDIATION IN BANKRUPTCY — AN IMPORTANT, ALBEIT UNWIELDY TOOL

In this article the author acknowledges that mediation is now a staple of large chapter 11 bankruptcy cases, but she notes issues that make mediation an unwieldy tool in the bankruptcy context.

By Julia Winters *

Mediation is now a staple of large chapter 11 bankruptcy cases, particularly those cases involving mass tort litigation. Despite the increased use of mediation, there remain aspects of the practice that simply do not work as well in bankruptcy as in other fora. This article discusses recent trends in bankruptcy mediation, in particular, in the mass tort case context, and highlights some of the square-hole-round-peg issues with mediation that arise in bankruptcy cases.

MEDIATION HAS BECOME UBIQUITOUS IN CHAPTER 11 CASES

The Alternative Disputes Resolution Act of 1998 required each district court to authorize "the use of alternative dispute resolution processes in all civil actions, including adversary proceedings in bankruptcy."[1] Since its passage, mediation has become ubiquitous in large, chapter 11 bankruptcy cases in the United States.[2] With its rise, bankruptcy courts have established local rules and/or standing orders to address how mediation can, and should be, employed. According to one survey, at least 80 percent of bankruptcy court districts had adopted local rules regarding mediation as of August 30, 2018.[3]

The districts where most large, chapter 11 cases are filed — Delaware, Southern District of New York, and the Southern District of Texas — all have standing orders, local rules, or procedures governing the practice.[4] The District of Delaware also *mandates* mediation in all

[1] 28 U.S. C. § 651.

[2] Prior to its passage, bankruptcy courts used the general, Power of Court, provision of the Bankruptcy Code to order mediation. 11 U.S.C. § 105.

[3] A List of Bankruptcy Districts That Have and Have Not Adopted Local Mediation Rules, August 30, 2018, *available at* https://mediatbankry.com/2016/12/06/a-list-of-bankruptcy-districts-that-have-and-have-not-adopted-local-mediation-rules/.

[4] *In re*: Procedures Governing Mediation of Matters and the use of Early Neutral Evaluation and Mediation/Voluntary Arbitration in Bankruptcy Cases and Adversary Proceedings, United States Bankruptcy Court, Southern District of New York, June 28, 2013, *available at* https://www.nysb.uscourts.gov/content/mediation-procedures; Local Rule 9015-5 of the Local Rules for the United States Bankruptcy Court, District of Delaware, February 1, 2022, *available at* http://www.deb.uscourts.gov/content/rule-9019-5-mediation; Procedures for Complex Cases in the Southern District of Texas, Section S, August 1, 2021, *available at* https://www.txs.uscourts.gov/page/complex-chapter-11-cases.

* *JULIA WINTERS is a partner in the Insolvency & Restructuring Group at Katten Muchin Rosenman LLP. Her e-mail address is jwinters@katten.com.*

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adversary proceedings that include a claim to avoid a preferential transfer.[5]

MEDIATION CAN BE A POWERFUL BANKRUPTCY DISPUTE RESOLUTION TOOL

As with other alternative dispute resolution methods, mediation can be extremely useful in bankruptcy cases to narrow issues, to resolve actual or potential litigation, and to streamline proceedings. Parties have used mediation in bankruptcy to, among other things, resolve plan disputes, prepetition claims, and inter-creditor disputes. Mediation can be employed at various stages in bankruptcy cases — on the eve of plan confirmation, following summary judgment rulings in adversary proceedings, and even at the very inception of a chapter 11 case.

Perhaps more so than in any other type of bankruptcy case, mediation has become an essential component of mass tort chapter 11 filings. For instance, without mediation it may be impossible to get consensus around, or litigate to conclusion, the plan treatment of tort claimants or whether the releases sought by the debtor in exchange for distributions to tort claimants are reasonable and appropriate. As the bankruptcy court in the 2019 *PG&E Corporation* case explained when ordering mediation:

> After presiding over every hearing in these chapter 11 cases over the past nine months, the court is convinced that mediation should be attempted once again.
>
> Certain parties are polarized; the emotions are running higher and higher, the staggering costs (economic and otherwise) are multiplying daily and very recent events that need not be repeated here but are obvious to everyone in Northern California might make a successful reorganization even more of a challenge.
>
> . . .
>
> Meanwhile, as stated frequently by the court and others, thousands of wildfire victims, who stand before the court as involuntary creditors, await some resolution, albeit imperfect, to try to restore their economic losses, consistent not only with [the California Wildfire Fund bill], but more importantly, as compelled by the moral necessity of doing so.[6]

Indeed, nearly all (if not all) of the recent, high profile cases involving mass tort litigation have called on mediators to help determine the quantum of settlement consideration, the claimants entitled to recovery, how those recoveries are to be apportioned, and/or how mass tort settlements will be encompassed in a plan of reorganization.[7]

In re Purdue Pharma exemplifies the key role of mediation in mass tort bankruptcy cases.[8] Purdue Pharma filed for bankruptcy in the Southern District of New York on September 15, 2019, to address an "onslaught of lawsuits" related to the company's manufacture and sale of opioids brought by Federal and non-Federal governmental entities, as well as individuals, hospitals, and other non-governmental organizations.[9] The debtors commenced bankruptcy having already reached a settlement with numerous stakeholders, including their shareholders: the Sackler family, 24 state attorneys general, analogous officials from five U.S. territories, and a plaintiffs' executive

[5] Local Rule 9015-5(a), *available at* http://www.deb.uscourts.gov/content/rule-9019-5-mediation.

[6] Order Appointing Mediator, *PG&E Corporation*, Case No. 19-30088 (DM) (Bankr. N.D. Ca. October 28, 2019) at 2.

[7] In addition to the cases discussed herein, *see, e.g.*, Order (1) Appointing Mediators, (2) Referring Certain Matters to Mediation, and (3) Granting Related Relief, *In re Imerys Talc America, Inc., et al.*, Case No. 19-10289 (LSS) (Bankr. D. Del. November 30, 2021); Order (1) Appointing Mediators, (2) Referring Certain Matters to Mediation, and (III) Granting Related Relief, *In re Boy Scouts of America and Delaware BSA, LLC, et al.*, Case No. 20-10343 (LSS) (Bankr. D. Del. March 1, 2021).

[8] *In re Purdue Pharma L.P., et al.*, Case No. 19-23649 (RDD) (Bankr. S.D.N.Y. September 15, 2019) ("*Purdue Pharma*").

[9] Debtors' Information Brief, *Purdue Pharma*, September 16, 2019 at 1.

committee in multi-district litigation collectively representing over 1,000 plaintiffs.[10]

The Purdue Pharma debtors engaged in three mediations during the course of their bankruptcy case, first employing Kenneth Feinberg and Hon. Layn Phillips to mediate the relative allocation of settlement proceeds amongst different groups of opioid creditors from March through September 2020.[11] Then, after filing a plan of reorganization in March 2021, the bankruptcy court appointed fellow bankruptcy judge, Shelley C. Chapman, to mediate disputes over the plan's proposed releases of the Sackler family.[12] That mediation involved the debtors, the official unsecured creditors committee, an ad hoc committee of plaintiffs supporting the plan, the non-consenting states, the multi-state governmental entities group, and representatives of the Sackler family. The plan mediation, which lasted roughly two months, resulted in an incremental $50 million in the Sackler family's contribution to an opioid trust, and a settlement with 15 of the 24 non-consenting states.[13] Finally, after the district court reversed the bankruptcy court's order confirming the debtors' plan of reorganization (on the basis that the bankruptcy court lacked the jurisdiction to grant third-party releases of the Sackler family), the bankruptcy court ordered further mediation with Judge Chapman between the appealing non-consenting states and the Sackler family.[14] That mediation resulted in the Sackler's increasing their settlement contribution by over $1 billion and the nine appealing states agreeing to be bound by the plan releases.[15]

In re Mallinckrodt plc, et al. — the case of another pharmaceutical company facing thousands of lawsuits related to its manufacture and distribution of generic opioids — also involved mediation to clear a path to a plan of reorganization.[16] There, the debtors similarly employed Kenneth Feinberg to develop a mediated relative allocation of settlement proceeds among opioid creditors.[17]

More recently, the debtors in *Madison Square Boys & Girls Scouts, Inc.*, which filed in the Southern District of New York on June 29, 2022, sought mediation as part of their first day pleadings.[18] The debtors in that case face approximately 140 lawsuits alleging sexual abuse violations of New York's Child Victims Act, and commenced bankruptcy to "fairly and equitably" resolve those claims, through mediation for a 90-day period.[19]

DESPITE MEDIATION'S PROLIFERATION, BANKRUPTCY DYNAMICS COMPLICATE ITS USE

Although mediation has become a routine component of chapter 11 cases, and is likely necessary in some circumstances, readers should be mindful of the ways in which bankruptcy can make mediation an unwieldy tool. The sheer number of stakeholders in chapter 11 cases can complicate mediation and make it exceptionally expensive, particularly when there is a complex capital structure with different sets of creditors, each represented by their own counsel and financial advisors. In *Intelsat*, for example, the mediation involved at least nine parties, along with their lawyers and financial advisors.[20] While the advent of remote mediation sessions during the pandemic has alleviated some of the cost, bankruptcy mediation remains an expensive endeavor, albeit less costly than full-blown litigation.

Another tricky issue in bankruptcy mediation is how to engage in the process creditors who do not wish to remain restricted from trading during the mediation. One of the pillars of successful mediation is the engagement of principals, not just advisors.[21] However,

[10] *Id.* at 44-45.

[11] Order Appointing Mediators, *Purdue Pharma*, March 4, 2020.

[12] Order Appointing the Honorable Shelley C. Chapman as Mediator, *Purdue Pharma*, May 7, 2021.

[13] Mediator's Report, *Purdue Pharma*, July 7, 2021.

[14] Order Appointing the Honorable Shelley C. Chapman as Mediator, *Purdue Pharma*, January 3, 2022.

[15] Mediator's Fourth Interim Report, *Purdue Pharma*, March 3, 2022.

[16] *In re Mallinckrodt plc, et al.*, Case No. 20-12522 (JDD) (Bankr. D. Del. October 12, 2020) ("*Mallinckrodt*").

[17] Order (1) Appointing a Mediator and (2) Granting Related Relief, *Mallinckrodt*, February 11, 2021.

[18] *In re Madison Square Boys & Girls Scouts, Inc., et al.*, Case No. 22-10910 (SHL) (Bankr. S.D.N.Y. June 29, 2022) ("*Madison Square*").

[19] Declaration of Jeffrey Dold (1) In Support of First Day Motions and (2) Pursuant to Local Bankruptcy Rule 1007-2, *Madison Square*, June 30, 2022 ¶¶ 5-6.

[20] Order Compelling Mediation of Plan and Confirmation-Related Disputes and Appointing Judicial Mediator, *In re Intelsat S.A., et al.*, Case No. 20-32299 (KLP) (Bankr. E.D. Va. April 21, 2021).

[21] Indeed, the bankruptcy court for the district of Delaware mandates the participation of principals Local Rule 9015-5(C)(iii)(a), *available at* http://www.deb.uscourts.gov/content/rule-9019-5-mediation.

mediation can, and often does, include the exchange of material non-public information ("MNPI") regarding the debtor's financial condition and operations, which can cause creditors to run afoul of insider trading rules should they participate and trade at the same time.

This issue came to the forefront after the *Washington Mutual* bankruptcy case ("WaMu"). WaMu filed for bankruptcy in September 2008, at the height of the financial crisis.[22] Its banking business was sold by the FDIC to JPMorgan Chase, however ownership of certain WaMu assets remained in dispute following the sale. Four distressed debt investor-creditors participated in settlement negotiations over the treatment of the disputed assets. To avoid insider trading, the investors created formal restricted periods during which they participated in negotiations, were potentially exposed to MNPI, and did not trade. At the end of these restricted periods, WaMu would disclose any MNPI exchanged so that the investors could resume trading. The lock-up procedures were challenged by a group of shareholders, who argued that the investors' claims should be recharacterized, subordinated, or disallowed based on their trading on MNPI. The bankruptcy court held that there were "colorable claims" of insider trading, notwithstanding the blow-out mechanism.[23] The court determined that the investors could not rely on the debtors' determination of materiality, and that the investors may have temporarily assumed the role of a non-statutory insider by participating in the negotiations.[24]

Following the *WaMu* decision, some mediation orders have addressed the issue by providing comfort that a party's participation in mediation will not make it an insider.[25] In other instances, principals participate in general, all-party sessions, but leave the caucusing to their advisors, who can relay the non-MNPI components of offers or other materials exchanged to them, delegate decision making authority to an advisor, or create trading walls between the individuals participating in the mediation and the rest of the investment institution.[26] None of these solutions are perfect, however, and as *WaMu* aptly demonstrates, can be subject to challenge.

Similarly, the involvement of principals can be complicated by the role of private equity sponsors who may simultaneously be the target of litigation claims from the debtor's estate and control the debtor's board of directors — the decision makers who are either tasked with representing the company in mediation, or to whom officers delegated that responsibility report. In the absence of independent directors appointed to represent the estate's interests, parties can challenge the integrity of the mediation process when directors and officers affiliated with the sponsor are involved.

In addition, parties to bankruptcy disputes do not always neatly align on either side of a "v." There can be parties who are aligned for certain aspects of the dispute(s) — for example, how to value the assets available for creditor recoveries — while disagreeing on other aspects — such as how those assets should be distributed. Bankruptcy cases often involve simultaneous litigation and negotiations, and parties can (and often do) switch allegiances during the case, even while mediation is ongoing.

Further, a mediated resolution of one issue can give rise to new disputes between the parties. In that sense, mediation in bankruptcy can be like a game of whack-a-mole, where one resolution gives rise to new disputes and different allegiances. For example, as a result of the third Purdue Pharma mediation, the appealing states agreed to support the releases in the plan in exchange for additional consideration just to them. However, that mediated agreement prompted the State of Florida, which had previously supported the settlement with the Sackler family, to object on the ground that the deal struck with the appealing states afforded them

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[22] *In re Washington Mutual Inc.*, Case No. 08-12229 (MFW) (Bankr. D. Del. September 26, 2008).

[23] *In re Washington Mutual Inc.*, 461 B.R. 200 (Bankr. D. Del. 2011).

[24] *Id.* at 266.

[25] *See, e.g.*, Order Selecting Mediator and Governing Mediation Procedure, *In re Cengage Learning Inc.*, No. 13-44106 (ESS) (Bankr. E.D.N.Y. Sept. 25, 2013), at ¶ 12.

[26] *See, e.g.*, Order Appointing a Mediator, *In re Windstream Holdings, Inc., et al.*, No. 19-22312 (RDD) (Bankr. S.D.N.Y. July 30, 2019) ¶ 14 ("To extent any Mediation Party attends mediation and receives material non-public information, any such Mediation Party shall maintain internal information blocking procedures and shall not share any such information generated by, received from or relating to the mediation with any other of its employees, representatives or agents, including trading and investment advisor personnel, so that any such Mediation Party (excluding any employees, representative or agents that participated in the mediation and received material nonpublic information), notwithstanding this Order or anything in any confidentiality agreement to the contrary, may trade in any claims against the Debtors or the Uniti Entities . . .").

disproportionately favorable treatment in violation of Bankruptcy Code.[27]

CONCLUSION

Bankruptcy courts and parties have already taken steps to address the idiosyncrasies of bankruptcy mediation and will likely continue to adapt the practice. In the meantime, participants should be mindful that, given its complexity, bankruptcy mediation often leads to an 'art of the possible' settlement rather than a resolution that is acceptable all participants. This, of course, poses challenges of its own to the mediation parties who walk away unsatisfied. Not only are they outside a deal that has been blessed by an impartial mediator, they may not disclose any of the information gleaned during the mediation or even the conduct of the mediation due to sweeping mediation privilege. In short, sometimes in bankruptcy, mediation is a blessing and a curse, depending on whose side you're on. ■

[27] The State of Florida's Objection to the Motion of Debtors Pursuant to 11 U.S.C. § 105(a) and 363(b) for Entry of an Order Authorizing and Approving Settlement Term Sheet, *Purdue Pharma*, March 3, 2022.