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## Feature

By Damian S. Schaible and Eli J. Vonnegut[1]

# The Rise of Plan Mediation: Benefits and Pitfalls

**Damian S. Schaible**
*Davis Polk & Wardwell LLP; New York*

**Eli J. Vonnegut**
*Davis Polk & Wardwell LLP; New York*

*Damian Schaible is a partner and Eli Vonnegut is an associate with the Insolvency and Restructuring Group at Davis Polk & Wardwell LLP in New York. Mr. Schaible also serves on ABI's Board of Directors.*

Interested parties in the largest and most complex bankruptcy cases are increasingly turning to mediation as a means of reaching consensual plan terms, in addition to more targeted mediation of specific disputes. Plan mediation offers potentially significant cost savings and efficiency benefits, but it also entails risks. In addition to the potential for increased cost and delay from a premature, failed or mismanaged mediation, parties should be mindful of the risks relating to exposure to nonpublic information in the context of a mediation, particularly in the wake of Hon. **Mary F. Walrath**'s 2011 ruling in the *WaMu* bankruptcy regarding potential violations of the federal securities laws by participants in confidential settlement talks.[2] Judges and practitioners have begun developing certain creative means of seeking to address the risks highlighted by the *WaMu* ruling; however, no method is a panacea, and participants are well advised to be mindful of the drawbacks of each.

## The Benefits of Plan Mediation

Chief among the benefits of plan mediation is flexibility. Mediation is not a "one-size-fits-all" plan and can be tailored to address the needs of a specific case. In recent cases, the scope of plan mediation has ranged from narrowly tailored individual issues to broader efforts to achieve global settlement, while the processes themselves have ranged from highly formalized mini-trials to more loosely supervised settlement talks.

In the *Tribune* case, for instance, an informal process unfolded over several months with the goal of reaching the broadest possible settlement of claims stemming from Tribune's 2007 leveraged buyout and plan terms reflecting any agreed deals. Rather than fully briefing the issues, parties submitted streamlined, five-page term sheets to the mediator, along with ownership statements reflecting their respective economic stakes in the debtors' capital structure.[3] This minimalist structure was effective, given that the mediation occurred several years into the case after the parties' positions were well known. An informal approach also served to expedite and simplify the process, but still provided the parties with a forum to negotiate a settlement and a concise means of setting forth their positions for the mediator's benefit. The plan that emerged from these negotiations, while not fully consensual, had broad support and ultimately allowed the company to successfully emerge.[4]

Toward the more formal end of the spectrum, the plan mediation in the recent *Cengage Learning* case occurred much earlier in the case and began with a heavily negotiated list of topics to be mediated, continued for three rounds of formal mediation, and included formal briefing and argument on each topic in the dispute.[5] Although each issue was hotly disputed, the mediation ultimately helped the parties assign risk-weighted values to the issues in dispute, which laid the groundwork for a global settlement.

Although negotiations in *Tribune* and *Cengage* encompassed a range of issues relevant to ultimate plan terms, mediation can also be useful for narrower, single-issue disputes. In the *Lehman Brothers* case, for instance, a detailed mediation process was instrumental in helping to resolve disputes over the potential termination of many of Lehman's derivatives contracts. The mediation order for that process created a rotating panel of mediators and

1 The authors thank Nick Axelrod for his extensive assistance in the preparation of this article.
2 *In re Washington Mutual Inc.*, 461 B.R. 200 (Bankr. D. Del. 2011).
3 Order Appointing Mediator, *In re Tribune Co.*, No. 08-13141 (KJC) (Bankr. D. Del. Sept. 1, 2010), at ¶ 4.
4 *See In re Tribune Co.*, 464 B.R. 126, 207-08 (Bankr. D. Del. Oct. 31, 2011); *In re Tribune Co.*, 476 B.R. 843, 849-51 (Bankr. D. Del. 2012).
5 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 ¶ 2 (hereinafter, "*Cengage* Order").

set forth expedited procedures for the resolution of claims arising from the closeout of the portfolio.[6] Progress in the main case was able to continue during mediation, and by May 2012, more than 200 disputes referred to mediation had been settled without litigation, with total estate recoveries in excess of $1 billion.

More recently, in the chapter 9 proceeding of the *City of Detroit*, Hon. **Steven W. Rhodes** appointed District Judge Gerald Rosen early in the case as chief mediator to oversee a panel of mediators drawn from around the country, each focusing on a subset of the issues in the case.[7] The program, which was overseen by Judge Rosen, covered a wide range of disputes, including labor, debt and swap treatment, pension issues, other post-employment benefits and municipal finance issues, among others. Throughout the case, a variety of disputes have been referred to and successfully resolved through mediation that was overseen by Judge Rosen.

## Downside Risks: Delay and Expense

Recent experience with plan mediation reveals both benefits and significant risks. Structured mediation ensures a robust forum for dispute resolution — but it can also create an opening for delay, strategic or otherwise. Although the highly structured mediation in *Cengage* ultimately produced a workable settlement, extensive briefing over numerous rounds inevitably hindered progress in the broader case, and it would have left the company significantly behind schedule had it failed. While a dual-track process is sometimes attempted, as a practical matter, continuing to push forward on a plan or litigation process simultaneously is difficult and progress on other fronts once mediation begins is less likely. While an effective mediation can limit costs by avoiding full litigation or a contested plan process, unsuccessful mediation can leave parties effectively paying for two cases instead of one.

Avoiding these pitfalls requires attention to several key considerations, including the timing of mediation, its scope and the selection of the mediator. To ensure an effective process, timing of mediation in the case must balance the twin goals of commencing early enough to still offer the benefit of short-cutting full litigation, while not commencing so early that issues have not yet been clarified enough to allow for an efficient negotiation. Put another way, mediation should ideally commence after the parties' positions have become clear but before they have calcified.

In determining the scope of a mediation, there is also a balance to be struck: between the risk of too broad a mediation making progress impossible, and the risk of too narrow a mediation, which would not effectively facilitate meaningful progress in the broader case. Putting all issues in play at the same time, as was the case in *Tribune*, may facilitate a wide-ranging settlement, but lengthy lists of issues can also slow down the process and distract from the key determinants of settlement value, while leaving key issues out of a mediation can render a narrow settlement of limited value.

Finally, parties should choose a mediator with care. Increasingly, cases have made use of sitting or retired judges, who bring the significant benefit of being able to credibly opine on the strength of the parties' positions and are more cost-efficient than sitting judges. Professional mediators have been successful in a number of high-profile mediations; however, credibility with the parties and standing in the restructuring community are crucial to a mediator's success.

## MNPI in Bankruptcy and *WaMu*

In the wake of the *WaMu* ruling on insider-trading allegations related to confidential settlement talks, participants in all forms of confidential discussions in bankruptcy have been particularly focused on the risk that exposure to material nonpublic information (MNPI) might leave them unable to trade or vulnerable to allegations of improper trading. The basics of the *WaMu* case are instructive in understanding the decision's impact on market practice.

After the sale of Washington Mutual Bank to JPMorgan, the primary driver of value for the parent company's creditors was a dispute with JPMorgan over the ownership of certain disputed assets. Throughout the case, investors holding large positions in the WaMu capital structure participated in confidential settlement negotiations with JPMorgan, both through counsel and directly. To manage their exposure to MNPI, the investors established formal lock-up periods during which the investors participated in settlement talks directly and were exposed to nonpublic information, with WaMu agreeing to disclose any MNPI received by participants in the negotiations at the end of each lock-up period so that the investors could resume open trading.

In spite of these procedures, Judge Walrath found that there were "colorable claims" that the investors had traded improperly while in possession of MNPI.[8] Central to this holding were findings that even tentative settlement proposals that were rejected could be viewed as material, and investors were not entitled to rely on the debtor's conclusion that they were immaterial. In order to find potential liability, the court held that the investors may have assumed special duties and risks as temporary or nonstatutory insiders through their participation in negotiations.[9]

Importantly, the *WaMu* decision was not about traditional securities law liability. Instead, the decision focused on exposure to MNPI potentially leading to the imposition of equitable remedies based on potentially improper trading activity.

## Creditor Strategies for Managing MNPI

While the *WaMu* decision did not address the merits of any insider-trading claims and was subsequently vacated, it nonetheless highlights certain risks for creditors that may want, or be required, to participate in mediations in which they will be exposed to MNPI. Several tools can help ensure that nonpublic information is treated appropriately. Information walls between traders and those involved in mediation can allow both unfettered trading and active participation in negotiations, but they may be impractical for many holders. Although cleansing disclosures theoretically address concerns about possession of MNPI, judgments as to materiality carry the risk of being second-guessed by a court, and broad disclosure may be problematic for companies that

6 Alternative Dispute Resolution Procedures Order for Affirmative Claims of Debtors under Derivatives Contracts, *In re Lehman Bros. Holdings Inc.*, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Sept. 17, 2009), at ¶ 10.
7 Mediation Order, *In re City of Detroit, Michigan*, No. 13-53846 (Bank. E.D. Mich. Aug. 13, 2013).

8 *Washington Mutual Inc.*, 461 B.R. at 266.
9 *Id.*

are understandably hesitant to publicly disclose sensitive business information.

Restricting trading is an effective solution, but it has numerous drawbacks. Discrete restricted periods, such as were employed in *WaMu*, are ineffective without burdensome cleansing disclosure at the end of each period. Indefinite restriction, while apparently the *WaMu* court's favored solution, constrains liquidity and may deter stakeholders from participating in mediation in the first place.

## Recent Strategies for Managing MNPI

Issues raised by the *WaMu* decision and the inherent problems in available solutions to the MNPI dilemma have prompted parties and judges to reach for up-front fixes to encourage participation in mediation and limit its risks. Mediation orders in numerous cases since *WaMu* have addressed MNPI risk head-on, advancing a number of approaches to the problem.

The mediation order in the *General Motors* bankruptcy case embodies one extreme among the range of potential approaches.[10] The court's order explicitly spelled out the risks of participation and afforded no protection to the parties from the effects of exposure to MNPI. Parties to the mediation were required to acknowledge that they might receive MNPI during the mediation, and it warned that they would trade at their own risk.[11]

The court's order in *Cengage*, on the other hand, offered mediation participants comfort in order to encourage participation by addressing several elements of the *WaMu* decision, providing that "[n]o Party shall (a) be or become an insider ..., (b) be deemed to owe any duty to any Debtor Parties ..., (c) undertake any duty to any party in interest, or (d) be deemed to misappropriate any information" by taking part in the mediation.[12] The order also included a finding that settlement proposals would not be considered MNPI and squarely addressed the risk of equitable subordination: "No party in interest ... shall have ... any other basis to withhold, subordinate, disallow or relay payment ... on account of a claim based on such Party's trading in Debtor Party Securities by reason of a Party's participation in the Mediation as a result of receiving ... (b) a Settlement Proposal."[13] These provisions appear to be gaining some traction, as they were recently included in Hon. **Shelley C. Chapman**'s order appointing a mediator in the *LightSquared* case.[14] While it is not clear what weight these findings would have in a traditional insider-trading prosecution, they do offer participants in bankruptcy mediations the comfort that the presiding bankruptcy judge will not use their participation in the mediation as grounds for the imposition of equitable bankruptcy remedies, such as claim-subordination or disallowance.

Relatedly, a recent order in the *Momentive* bankruptcy case offers an example of another approach for creditors' committee members, who face regular exposure to MNPI in their roles as such. Based on a declaration from the committee member regarding the safeguards it intended to implement, Hon. **Robert D. Drain** entered an order holding that a committee member "will not subject its claims to possible disallowance, subordination, or other adverse treatment, by trading in [claims against the debtors] ... provided that [it] establishes and effectively implements and strictly adheres to the information blocking procedures detailed in the ... Declaration."[15] While not directly tied to a mediation, this order could provide a model for creditors that are willing to establish trading walls and want comfort that the presiding court is satisfied with those walls.

## Conclusion

The significant current market trend toward mediation, both with respect to plan terms and narrower disputes, is sure to continue. Mediation's flexibility allows parties to develop tailored processes to meet the particular needs and traits of each case. However, in negotiating these processes, parties should be attentive to the risks and benefits of decisions concerning formality, scope and timing. Parties must also be aware of the risk of exposure to MNPI during mediation, and the strengths, weaknesses and tradeoffs involved in each approach to managing MNPI. Careful design of a mediation process and order can both increase the odds of success and help effectively address the risks to participants. abi

**Editor's Note:** *ABI's Mediation Committee focuses on mediation and other ADR methods applied in the bankruptcy process, including conflict-resolution skills development, overcoming impasses, multiparty mediations, confidentiality and more. The committee is also considering Model Rules for courts on the use of mediation, mediator qualifications and compensation. Visit committees.abi.org/mediation to join this committee.*

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10 Stipulation and Agreed Order Appointing Mediator, *Motors Liquidation Co. v. Appaloosa Investment Ltd. P'ship I (In re Motors Liquidation Co.)*, Bankruptcy Case No. 09-50026 (REG), Adv. Proceeding Case No. 12-09802 (Bankr. S.D.N.Y. June 27, 2013).

11 *Id.* at ¶¶ 11.A and 13.

12 *Cengage* Order, *supra* n.5, at ¶ 12.

13 *Id.* at ¶ 13.

14 Order Selecting Mediator and Governing Mediation Procedure, *LightSquared LP, et al., v. SP Special Opportunities LLC, et al.)*, Bankruptcy Case No. 121280 (SCC), Adv. Proceeding Case No. 13-1930 (Bankr. S.D.N.Y. May 28, 2014).

15 Order Granting Motion of Aurelius Capital Partners LP for Entry of an Order Approving Specified Information Blocking Procedures and Permitting Trading of Claims Against the Debtors Upon Establishment of a Screening Wall, *In re MPM Silicones LLC*, No. 14-22503 (RDD) (Bankr. S.D.N.Y. May 12, 2014), at 2.