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ALTERNATIVE DISPUTE RESOLUTION IN U.S. BANKRUPTCY PRACTICE

JACOB A. ESHER *

I. INTRODUCTION

Alternative Dispute Resolution (ADR) has become firmly established in our contemporary legal system and continues to grow in bankruptcy practice. The Alternative Dispute Resolution Act of 1998¹ requires that each federal district court authorize, by local rule, the use of ADR in “all civil actions, including adversary proceedings in bankruptcy”²

On August 12, 1997, the National Bankruptcy Review Commission (Commission) adopted its Chapter 11 Working Group’s Proposal No. 18 as one of the Commission’s official recommendations to Congress. The Proposal recognizes that

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¹ Pub. L. No. 105-315, 112 Stat. 2998 (codified as amended at 28 U.S.C. §§ 651–58 (1998)).

² 28 U.S.C. § 651(b) (The adoption of mediation procedures was also recommended by the National Bankruptcy Review Commission in its October 20, 1997 Final Report, *BANKRUPTCY: THE NEXT TWENTY YEARS*).

ADR benefits disputants because it reduces the need for costly and inefficient litigation and usually results in greater satisfaction than the litigation alternative. The Commission's recommendation is as follows:

A. Authorization for Local Mediation Programs

Congress should authorize judicial districts to enact local rules establishing mediation programs in which the court may order non-binding, confidential mediation upon its own motion or upon the motion of any party in interest. The court should be able to order mediation in an adversary proceeding, contested matter, or otherwise in a bankruptcy case, except that the court may not order mediation of a dispute arising in connection with the retention or payment of professionals or in connection with a motion for contempt sanctions, or other judicial disciplinary matters. The court should have explicit statutory authority to approve the payment of persons performing mediation functions pursuant to the local rules of that district's mediation program who satisfy the training requirements or standards set by the local rules of that district. The statute should provide further that the details of such meditation programs that are not provided herein may be determined by local rule.³

³ NAT'L BANKR. REV. COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS 489 (Final Report, Oct. 20, 1997) (Throughout its deliberations, the Commission noted the importance of reducing unnecessary costs of the bankruptcy process. This principle has been a prominent theme of its recommendations thus far. Many judges and attorneys have noted that mediation has become a lower-cost, higher-satisfaction alternative to litigation. In the bankruptcy field, clear statutory authority would facilitate the development of mediation programs.).

The Commission's position was neither novel nor surprising.⁴ From the Bankruptcy Court's perspective, ADR also alleviates the strain on the court system caused by rising bankruptcy filings and increased pressure to streamline dockets.⁵

Parties have used mediation, the preferred method of voluntary dispute resolution, to resolve a wide range of bankruptcy disputes, from simple claim objections to complex, multi-party Chapter 11 plan negotiations that have become protracted or reached an impasse.⁶ It has been particularly effective in large case claim reconciliation programs.⁷ Adversary proceedings, particularly preference and other avoidance actions, are often referred to mediation. The Middle District of Florida has enjoyed notable success in the mediation of claims involving the Internal Revenue Service.⁸

⁴ See Barbara Franklin, *ADR Meets Bankruptcy: Experts Explore Ways to Abbreviate the Process*, 209 N.Y.L.J. 5, Apr. 22, 1993 ("ADR may, in a lot of cases, offer a more efficient resolution of controversies and disputes than litigation in the bankruptcy court . . . It's a long time from the filing of a petition to plan confirmation. Given the cost to creditors and everybody else, virtually anything you can do to expedite these proceedings is worthwhile.") (quoting Professor F. Stephen Knippenberg); Peter Blackman, *AAA's New Director Slate Brings Business Twist to Non-Profit Group*, 211 N.Y.L.J. 5, Apr. 14, 1994 ("Areas ripe for greater use of mediation include . . . bankruptcies.") (quoting William K. Slate II); See generally Robert G. Bone, *Mapping the Boundaries of the Dispute: Conceptions of Ideal Lawsuit Structure from the Field Code to the Federal Rules*, 89 COLUM. L. REV. 1, 3 (1989) ("Jurists today complain about the excessive costs and the unreasonable delay of litigation, the result, they argue, of an overburdened court system and overzealous advocacy.").

⁵ David D. Bird, Clerk Commentary, *Mediation as a Case-management Tool*, 23-4 AM. BANKR. INST. J. 18 (May 2004).

⁶ *In re R.H. Macy & Co.*, Case Nos. 92 B 40477 to 92 B 40486 (Bankr. S.D.N.Y. 1992).

⁷ E.g., *St. Johnsbury Trucking Co. v. Mead, Johnson & Co.* (*In re St. Johnsbury Trucking Co.*), Case No. 93-B-43136 (FGC), Adv. Pro. No. 93/9785A (Bankr. S.D.N.Y. 1993); *In re Eagle Bus Mfg., Inc.*, Case No. 90-00986-B-11 (Bankr. S.D. Tex. 1990).

⁸ See BCD NEWS & COMMENT (LRP Publications Apr. 16, 1992).

Methods of ADR continue to proliferate. The rapid growth in recent years stems from dissatisfaction with some aspects of traditional court adjudication. For instance, the high cost and protracted nature of litigation, the lack of predictability of the result, the escalation of conflict that the adversary context nurtures, and at the client level, the loss of control as the problem takes on a life of its own in the hands of lawyers and judges in the complex and sometimes mystical legal machinery. Increasingly though, parties are choosing ADR, especially mediation, for its own positive qualities, in particular, its flexibility and efficiency.⁹ The following description of mediation illuminates why:

Mediation is an ADR process of assisted negotiation that is unlike a court proceeding. It relies upon self determination in the same way that negotiation does. One commonly cited definition of mediation is: “Mediation is a party-driven, non-binding process in which disputants seek an impartial person to assist them in the resolution of their differences.”¹⁰

The process is characterized as “non-binding” because the mediator is not authorized to render a decision concerning the outcome of the dispute. By facilitating the parties’ negotiation through a combination of joint sessions as well as separate meetings with each party (referred to as “caucuses”), the mediator helps the parties define a range within which settlement is possible. Parties and their attorneys can be more candid with the mediator as a result of the confidentiality of caucuses. Placed as a buffer between the parties, negotiations through the mediator minimize positioning and other obstacles to reaching settlement, maximizing the potential effectiveness of negotiation. Each party must only be

⁹ See LINDA R. SINGER, *SETTLING DISPUTES: CONFLICT RESOLUTION IN BUSINESS, FAMILIES, AND THE LEGAL SYSTEM* 10–11 (Westview Press 1990).

¹⁰ JACOB A. ESHER, LISA H. FENNING & ERWIN I. KATZ, *AM. BANKR. INST., ABI GUIDE TO BANKRUPTCY MEDIATION* 3 (2d ed. 2009).

prepared and authorized to resolve the dispute and to participate in the process in good faith.¹¹

[In some circumstances,] ADR is not always a suitable or desirable replacement for court adjudication. ADR cannot establish legal precedent or deter future parties from bringing similar claims. Similarly, [non-binding] ADR processes . . . do not generally allow for immediate provisional relief. ADR's private nature makes it inappropriate when the public has an overriding interest in the outcome . . . of the dispute. ADR, while generally viewed as quick and efficient, can provide an opportunity to delay and harangue when a frivolous claim may warrant quick dismissal. More importantly, significantly unequal bargaining power between potential litigants can sometimes distort the ADR process and produce unfair results.¹²

Presently, approximately fifty of the ninety bankruptcy courts in the United States are using mediation pursuant to local bankruptcy rules, general orders, or guidelines.¹³ Several more are at some stage of consideration regarding the implementation of an ADR program, and others have been noted for frequent *ad hoc* use of ADR or an existing federal district court mediation rule.¹⁴ These numbers are continually changing and increasing.¹⁵ The proliferation of mediation

¹¹ *Id.* at 3–4.

¹² *Id.* at 8.

¹³ See JACOB A. ESHER, AM. BANKR. INST., COMPENDIUM OF BANKRUPTCY COURT LOCAL RULES ON ADR (21st Annual Winter Leadership Conference 2009).

¹⁴ See ROBERT J. NIEMIC, FED. JUDICIAL CTR., BANKRUPTCY COURTS WITH ADR PROCEDURES (Jan. 2000) (working paper on file with the author); See JACOB A. ESHER, AM. BANKR. INST., COMPENDIUM OF BANKRUPTCY COURT LOCAL RULES ON ADR (21st Annual Winter Leadership Conference 2009).

¹⁵ See ROBERT J. NIEMIC & JEFFREY REICH, FED. JUDICIAL CTR., ADR IN BANKRUPTCY COURTS: SUMMARY OF LOCAL BANKRUPTCY RULES & GENERAL ORDERS ON ADR (1994) (unpublished draft on file with the author) (the Federal Judicial Center's preliminary report in 1994

programs in our bankruptcy courts mirrors the development of ADR in the judicial system generally. The Alternative Dispute Resolution Act of 1998 and prior federal legislation have resulted in the development of ADR programs in the nation's federal district courts.¹⁶ Many state courts have developed ADR programs as well. The Executive Branch of the U.S. Government has encouraged the use of ADR,¹⁷ particularly in the Department of Justice.¹⁸

*B. Local Rules: Authority to
Promulgate Bankruptcy Rules*

The bankruptcy court's authority to promulgate local rules stems from 28 U.S.C. § 2075, which vests authority in the Supreme Court to prescribe rules governing procedure and practice in bankruptcy cases and proceedings. According to section 2075, these rules "shall not abridge, enlarge, or modify any substantive right." In addition, the procedural rules cannot conflict with Acts of Congress.¹⁹ The legislative

indicated nine bankruptcy courts with mediation programs, nine considering such a program, and seven with frequent ad hoc ADR use); *See* ROBERT J. NIEMIC, *FED. JUDICIAL CTR., MEDIATION IN BANKRUPTCY: THE FEDERAL JUDICIAL CENTER SURVEY OF MEDIATION PARTICIPANTS 5* (1998) (by 1998, at least twenty-eight bankruptcy courts (or approximately 30%) had local rules, general orders or guidelines in place that governed judicial referral of bankruptcy matters to mediation); *See* JACOB A. ESHER, *AM. BANKR. INST., COMPENDIUM OF BANKRUPTCY COURT LOCAL RULES ON ADR* (21st Annual Winter Leadership Conference 2009) (by the summer of 2008, only forty of the nation's bankruptcy courts did not have local rules concerning ADR).

¹⁶ 28 U.S.C. §§ 651-658 (1998); Civil Justice Reform Act, 28 U.S.C. § 471 (1990); Judicial Improvements & Access to Justice Act, Pub. L. 100-702, 102 Stat. 4642-72 (1988); *See* ELIZABETH PLAPINGER & DONNA STIENSTRA, *FED. JUDICIAL CTR. & CPR INST. FOR DISP. RESOL., ADR & SETTLEMENT IN THE FEDERAL DISTRICT COURTS: A SOURCEBOOK FOR JUDGES AND LAWYERS* (1996) (a comprehensive and detailed work on federal district court ADR programs and results).

¹⁷ Exec. Order No. 12988, 61 Fed. Reg. 26 (Feb. 5, 1996).

¹⁸ 28 C.F.R. § 50.20 (2009).

¹⁹ 28 U.S.C. § 2075 (2005).

history indicates that Congress intended to convey “broad rule-making power” and courts have upheld rules aimed at promoting efficiency in the courts.²⁰

Bankruptcy Rule 9029 of the Federal Rules of Bankruptcy Procedure delegates to the federal district courts the authority to make and amend local rules governing practice and procedure in bankruptcy cases and proceedings. However, in virtually every district, the district court has delegated the local bankruptcy rule-making power to bankruptcy judges. Rule 83 of the Federal Rules of Civil Procedure governs the procedure for making local rules under Bankruptcy Rule 9029. To be valid, a local rule governing bankruptcy cases must not abridge, enlarge or modify any substantive right established by the Constitution or the Bankruptcy Code, and must be a matter of procedure not inconsistent with the Bankruptcy Rules.²¹

C. Bankruptcy Court Local Rules on ADR

As noted previously, many bankruptcy courts have promulgated local rules providing for court-annexed ADR programs. For example, the Bankruptcy Court for the District of Massachusetts adopted Standing Order 09-04 on November 3, 2009, joining the ranks of many courts maintaining a list or register of mediators and providing for confidentiality and other procedural safeguards and encouragements for using mediation in bankruptcy cases. Other courts have adopted local rules or enacted general orders authorizing the use of ADR procedures in bankruptcy cases without a court-annexed program.²²

²⁰ *Bonner v. Adams*, 734 F.2d 1094, 1099 (5th Cir. 1984) (quoting H.R. REP. NO. 308, 80th Cong., 1st Sess., at A169 (1947)).

²¹ *See Indus Fin. Corp. v. Falk*, 96 B.R. 901, 903–4 (Bankr. D. Minn. 1989) (citing 28 U.S.C. § 2075 (2005)).

²² *See generally* JACOB A. ESHER, AM. BANKR. INST., COMPENDIUM OF BANKRUPTCY COURT LOCAL RULES ON ADR (21st Annual Winter Leadership Conference 2009).

ADR has become an integral and substantial part of the legal landscape affecting bankruptcy practice as much as other practice areas, such as employment law, labor law, and marital dissolution. It is also important to recognize the large number of mediation programs in state courts around the country in which disputes are resolved involving insolvency-related matters.

D. ABA Model Local Rule

The American Bar Association (ABA), through its Task Force on ADR in Bankruptcy, formed by the Chapter 11 Subcommittee of the ABA Business Bankruptcy Committee, has drafted a model local rule implementing a court-annexed mediation program.²³ The document, which was issued in final form on February 1, 1996, is the product of highly knowledgeable drafters, and represents a collective effort to set forth a model of suggested provisions to include in a local bankruptcy rule implementing a court-annexed program. Court-annexed programs customarily maintain a roster of neutrals that have been approved by the particular court to provide dispute resolution services to litigants, and set forth detailed rules regarding the use of mediation or other forms of alternative dispute resolution in pending cases. Many provisions of the ABA Model Rule were drawn from existing local rules in use in various bankruptcy courts around the country.

²³ See CHAPTER 11 THEORY AND PRACTICE: A GUIDE TO REORGANIZATION (James F. Queenan, Jr., Philip J. Hendel & Ingrid M. Hillinger eds., LRP Publications 1994) (A copy of the Model Rule is reproduced in full in Appendix D, and is on file with the author).

The Model Rule includes the drafters' commentary on the various provisions of the Rule, as well as an explanation when the Rule states alternative versions. This commentary provides an excellent analysis of the differing treatment of various provisions found in existing programs, and is highly instructive concerning basic principles of dispute resolution. Since its release, the ABA Model Rule has been used as the basis for the local rules in such jurisdictions as California,²⁴ New York²⁵ and Delaware²⁶, to name a few.

E. Importance of a Local Rule

On a substantive basis, adoption of a local rule or standing order is particularly helpful in disposing of objections by third parties to the use of ADR. Such parties may not be directly involved in the controversy for which mediation has been proposed, or may be merely recalcitrant in a multi-party dispute in which the majority of parties wish to initiate an ADR process. In such cases, the existence of a local rule will support the court's authority to mandate the use of an ADR process and require participation when it is determined that an objecting party has not demonstrated good cause for being excused. This would be particularly helpful in large case claim reconciliation efforts involving hundreds of claimants, where several claimants typically object to the proposed procedure. The existence of a local rule authorizing the use of ADR would ensure that the efficiency and cost savings, which can result from the use of an appropriate ADR process, will remain available despite the views of the reluctant few.

²⁴ See Second Amended General Order 95-01 of the Bankruptcy Court for the Central District of California.

²⁵ See Local Bankruptcy Rule 9019-1 and General Order M-143 of the Bankruptcy Court for the Southern District of New York.

²⁶ See Local Bankruptcy Rules 9019-2 to -6 of the Bankruptcy Court for the District of Delaware.

II. ADR AND CLAIM RESOLUTION

A. *Resolving Claims in a Facility*

Structured negotiation and ADR processes (facilities) have become more commonly used in bankruptcy cases, particularly for the resolution of large groups of claims. While these processes are brought to the courts for approval denominated as “ADR” or “Mediation” procedures, in practice the ADR aspect of the procedure is hardly used. The preliminary structured negotiation provisions of the approved procedure have typically resulted in the settlement of most of the claims before the resort to mediation or arbitration would come into play under the procedure.

Facilities have been most often used successfully in bankruptcy cases to settle contingent and unliquidated tort claims, including personal injury and wrongful death claims. In one of the first uses of the facility, the procedure implemented in the Greyhound Bus case involved over three thousand claimants.²⁷ The jurisdictional limitations of the bankruptcy court in dealing with wrongful death and personal injury claims²⁸ make the use of a facility particularly important. Without it, the debtor or trustee is forced to resolve these claims in multiple venues with multiple attorneys. However, the facility can as readily be utilized for any group of claim objections where it is believed that a substantial number of claimants would otherwise respond to an omnibus claim objection and not simply default, obviating the need for any procedures to be used.

²⁷ Greyhound Lines, Inc. v. Rogers (*In re* Eagle Bus Mfg., Inc.), 62 F.3d 730, 733, 734 n.6 (5th Cir. 1995).

²⁸ 28 U.S.C. § 157(b)(2)(B) (2005).

For example, in a Chapter 11 case where the debtor has scheduled numerous claims and numerous proofs of claim have also been filed, the debtor could file an omnibus objection together with a motion to direct all responding claimants into a facility. Claimants who do not respond within the deadline set by the court would have their claims disallowed in accordance with the usual claim objection procedure. Claimants who respond would be directed to the facility. The facility would provide that upon conclusion of the structured negotiation phase, unresolved claim objections would be mediated. If desired, objections failing to be resolved in mediation could then be subject to binding arbitration.

While these procedures may seem to involve more steps than a litigated claim, in reality the steps are far more economical, in time and cost, than any litigation process. In all of the cases in which a facility has been used, the number of claims ultimately requiring the final step, whether arbitration or litigation, is few.

The purpose of using a facility is to obtain an efficient resolution of claims at reasonable values and without the expense of litigation. Through carefully crafted step-by-step procedures, the facility promotes the exchange of necessary information and maximizes the prospects of reaching a negotiated settlement through a mandatory offer-counteroffer procedure. Since these procedures are not court-based and, therefore, not governed by formal rules of evidence and procedure, there is a significant saving of time and cost for all parties. In addition, a facility includes confidentiality provisions that are more comprehensive and protective than Federal Rule of Evidence 508, the rule that otherwise applies to settlement discussions. For example, a well-drafted facility will provide that the exchange of information, offers and counter-offers may not be introduced in court for any purpose, including impeachment, and that disclosure of privileged information will not constitute a waiver of the applicable privilege.

The facility can be set forth as part of the debtor's plan, or it may be initiated prior to a plan and incorporated into a subsequently filed plan. A facility can save time and cost for the estate as well as the claimants, minimize administrative expenses in cases, and achieve high rates of claim settlements with minimal court intervention. Parties and their attorneys often report a higher degree of satisfaction with the use of a facility as compared to the traditional litigation process.

III. ADR AND PLAN FACILITATION

A. *Use of Mediation to Reach Consensual Plans*

In recent years, several bankruptcy courts have appointed mediators to serve as facilitators for plan negotiations. In the earlier cases, courts used the power of appointment of an examiner²⁹ for this purpose.³⁰ However, the investigative functions and duty to report to the court placed on the examiner undermine important principles of mediation involving impartiality and confidentiality. Assumedly in response to this concern, some courts have limited the examiner's powers and restricted the role to a more facilitative one.³¹ Since other authority exists for the court's appointment of a mediator, relying on the examiner appointment powers is unnecessary and problematic.

²⁹ 11 U.S.C. § 1106(a)(3) (2005) (provides for an examiner's investigation of any "matter relevant to the case or to the formulation of a plan").

³⁰ *In re Apex Oil Co.*, 111 B.R. 235 (Bankr. E.D. Mo. 1990), *rev'd*, *in part on other grounds*, 132 B.R. 613 (Bankr. E.D. Mo. 1991), *aff'd in part, rev'd in part*, 960 F.2d 728 (8th Cir. 1992); *In re Public Service Co. of N.H.*, 99 B.R. 177 (Bankr. D. N.H. 1989); *In re UNR Indus., Inc.*, 72 B.R. 789 (Bankr. N.D. Ill. 1987).

³¹ *See, e.g., In re Apex Oil Co.*, 111 B.R. 235 (Bankr. E.D. Mo. 1990), *rev'd, in part on other grounds*, 132 B.R. 613 (E.D. Mo. 1991), *aff'd in part, rev'd in part*, 960 F.2d 728 (8th Cir. 1992) (in which the court precluded the examiner from appearing on any disputed matter).

Recent precedent supports the appointment of a paid mediator to resolve impasses in plan negotiation or competing plans.³² These cases are primarily larger, multi-party reorganizations, in which the estate has paid the costs and compensation of the mediator. However, the cost-effectiveness and efficiency of mediation would benefit smaller cases, at least as much where plan negotiations have broken down and the appointment of mediators in such cases has proven to be valuable.³³

The traditional ADR process of settlement conference by referral to another judge has also been used for plan impasses.³⁴ In some cases, the settlement judge has functioned as a mediator.³⁵ As more judges receive formal training in mediation, and where caseloads permit judicial resources to become more available, such referrals may be made more often. However, it is important to note that the necessary shift from an evaluative role to a more facilitative role can be difficult for a judge in functioning as a mediator. Parties and counsel are apt to pay greater deference to a judge than they would normally pay to a mediator. This perception

³² See, e.g., *In re* R.H. Macy & Co., Case Nos. 92 B 40477 to 92 B 40486 (Bankr. S.D.N.Y.); *In re* El Paso Electric Co., Case No. 92-10148-FM (Bankr. W.D. Tex.); *In re* Eagle-Picher Indus., Case No. 1-91-00100 (Bankr. S.D. Ohio); *In re* Zale Corp., Case No. 392-30001-SAF-11 (Bankr. N.D. Tex.); *In re* John Breuner Co., Case No. 93-47076-J (Bankr. N.D. Cal.); *In re* Enden, Inc., Case No. 90-22343-GM (Bankr. S.D. Cal.); *In re* Carabetta Enterprises, Case Nos. 92-51917 to 92-52126 (Bankr. D. Conn.).

³³ The Northern District of California has reported the use of ADR for seven plan disputes during the period of July 1, 1994 to January 15, 1996. (*Bankruptcy Dispute Resolution Program Statistics*, July 1, 1994–January 15, 1996 (Bankr. N.D. Cal. 1996)) (on file with the author).

³⁴ See, e.g., *In re* Family Health Services, Case No. SA 89-01549 JW (Bankr. C.D. Cal. 1989); *In re* Thorton Wholesale Florist, Inc., Case No. 93-11000-H11 (Bankr. S.D. Cal.).

³⁵ *In re* MCorp Financial Co., Case No. 93-2749 (5th Cir. 1994) (Bankruptcy Judge Steven A. Felsenthal was appointed by the 5th Circuit to serve as a mediator); *In re* Valley Forge Plaza Associates, Case No. 89-11136S (Bankr. E.D. Pa. 1990) (Hon. David Scholl appointed Bankruptcy Judge Judith H. Wizmur as mediator, resulting in a consensual plan).

can adversely impact upon the level of trust developed between parties and counsel with the mediator, lessening the degree of candor that is instrumental to a successful mediation.

IV. CONCLUSION

The use of ADR in bankruptcy cases, while firmly established in concept across the nation, has been realized in a minority of jurisdictions. Mediation training of judges, lawyers and professionals of other disciplines, together with the continued development of ADR programs, is necessary to achieve the vision of a judicial system in which both adjudicative and non-adjudicative, or negotiative, dispute resolution services are available to all parties in all cases.