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Mediation Matters

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Balancing Private Interests and Judicial Oversight

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Mediation is typically viewed as a net positive: helping parties-in-interest reach resolution in a cost-efficient manner. When implemented prior to any judicial action, a successful mediation is strictly a private affair between the parties and mediator. However, mediation often arises while a judicial action is pending.

When that occurs, the private interests of the parties in reaching resolution is joined by another factor: the judicial system's commitment to the fair administration of justice. This article discusses the intersection of private and public interests in mediation, including two specific cases where the intersection of such interests collided.

Mediation Perspectives

Over the past six years, this column has generated nearly three dozen articles[1] focused on the successful use of mediation in bankruptcy proceedings. Those authors, as well as members of ABI's Mediation Committee,[2] have helped raise awareness in the insolvency community of opportunities to incorporate and utilize mediation in business and consumer cases large and small.

While mediation is generally viewed as a helpful mechanism in appropriate situations, it is important to understand that there are still skeptics. For example, some commentators have asked (outside of the insolvency context) whether mediation poses a threat to justice at both individual and social levels.[3] Such critics have raised concerns about risks to privatizing dispute resolution and disaggregating claims of collective injustice.[4]

Public policy concerns — whether from a social justice perspective or a fair administration of justice perspective — can be magnified when mediation is used to resolve a dispute pending before a court. The two cases discussed herein serve as an important reminder for parties and mediators to address not just the private interests at stake, but also the need to heed the judicial system's commitment to the public interest in administering justice.

Vacating a Judicial Opinion

The *LeClairRyan* bankruptcy case provides an example of the complexities in trying to balance the parties' interests in resolving disputes in mediation and the judiciary's interest of the public value in prior judicial decisions. In this case, the chapter 7 trustee filed a motion to approve a settlement agreement reached in a Fourth Circuit mediation.[5]

The proposed settlement sought to resolve two separately contested motions whereby one of the law firm debtor's cofounders appealed rulings from the bankruptcy court that involved his inclusion on the debtor's equity security holders (ESH) list. Specifically, these motions were the (1) motion to amend the debtor's ESH list pursuant to Rule 1009(a) of the Federal Rules of Bankruptcy Procedure; and (2) motion for an order approving the chapter 7 trustee's reliance on the debtor's ESH list and procedures for obtaining copies of the filed tax returns and memorandum in support thereof.

The cofounder claimed that the chapter 7 trustee had inaccurately treated him as a member of the debtor despite his membership interest terminat-

1 These published articles are *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on Oct. 23, 2023).
2 Learn more at abi.org/membership/committees/mediation.
3 Robert A. Baruch Bush & Joseph P. Fogler, "Mediation and Social Justice: Risks and Opportunities," 27 *Ohio St. J. on Disp. Resol.* 1 (2012).
4 *Id.* at 5-6.
5 *LeClairRyan PLLC*, Case No. 19-34574 (Bankr. E.D. Va.), Motion (I) for Approval of Comprise and Settlement and (II) to Shorten Time, and Memorandum of Law, ¶ 14.

ing prior to the bankruptcy filing.[6] The cofounder claimed that his inclusion on the ESH list caused him to be inappropriately taxed on phantom income, which, in turn, exposed him to a significant tax burden as an equityholder.[7]

On appeal, the district court affirmed both orders, and the cofounder subsequently appealed to the U.S. Court of Appeals for the Fourth Circuit. The parties then commenced mediation pursuant to Fourth Circuit procedure. The chapter 7 trustee reported that numerous sessions had been held in an attempt to resolve the parties' dispute, and a settlement had been reached that was subject to court approval. The chapter 7 trustee's motion to approve the settlement agreement included several key provisions, including the following:

> 5) Joint motion under Bankruptcy Rule 8008 for indicative rulings as follows:
>
> A. That the Bankruptcy Court will vacate its opinion and order on Motion to Amend (Dkt. 1301, 1302); and
>
> B. That the Bankruptcy Court will grant relief under Rule 59/60 or other appropriate basis and modify its orders on Motion to Authorize (Dkt. 1311, 1313) to remove references to Motion to Amend opinion and order.
>
> 6) Joint Motion under FRCP 62.1 for indicative ruling that the District Court will vacate its opinion and order (Dkt. 21-22)....
>
> 8) Joint Motion for limited remand to [the] District Court and Bankruptcy Court to formally rule on their indicative rulings.
>
> 9) Joint motions seeking that the District Court and Bankruptcy Court vacate/modify their opinions and orders in accordance with the indicative rulings, as set forth above.

The chapter 7 trustee acknowledged that the motions seeking to vacate the orders in both the district and bankruptcy courts were not yet before those respective courts for approval, then went on to state the following:

> While not currently before this Court for approval, the Trustee acknowledges that a critical aspect of the Settlement as it relates to the Appeal is the vacatur of certain court orders/opinions by this Court and the District Court. And, the Trustee appreciates that to prevail, the parties will have to demonstrate exceptional circumstances (among other things). The Trustee maintains that the same exists given the unique circumstances in this bankruptcy case. As such, she is prepared to move forward to seek the same from this Court and the District Court if the Settlement is approved.

While the settlement agreement resolved several issues on appeal and included these provisions to vacate orders that the chapter 7 trustee carefully noted would require further court approval, the mere act of requesting the courts to review these decisions trigged a strong judicial response. Specifically, judges from both the bankruptcy and district courts initially refused to grant the motions to approve the settlement agreement, noting that the deal was "offensive" and "presumptuous," that the "vacating opinions [were] not an option" and "[i]t's not something subject to negotiation. We don't do that here." One judge even further critiqued the chapter 7 trustee at the hearing, stating that "I want to tell you, I better never again see any kind of language like this from your office, and if that happens, you won't be doing trustee work anymore."[8]

The district court ultimately issued a memorandum opinion further detailing its rationale for striking the *vacatur* components of the proposed settlement.[9] The judicial response surrounding the terms of the mediation agreement in this case highlights the tension that can arise between the resolution of private interests of parties and the public interest of the judiciary in the disposition of any dispute pending before a court.

Judicial Oversight

In the matter of *Cody W. Smith*,[10] the parties attempted to retain Hon. **Leif M. Clark** (ret.), a former bankruptcy judge, as a mediator without seeking court approval or notifying the court of their plans to mediate the dispute.[11] In rejecting that proposal, the court wrote an extensive opinion focused on two points:

> First ... [to] emphasize that obtaining *nunc pro tunc* approval of the employment of a former bankruptcy judge as a mediator is unacceptable because it creates an appearance of cronyism between the ex-judge and the sitting judge adjudicating the dispute to be mediated.
>
> Second ... [to] emphasize to the practicing bar that this Court's approval of mediation will never be automatic — even if all parties request it. Rather, the parties must convince this Court that mediation is appropriate under all of the circumstances on a case-by-case basis.

In addressing the concern of appearance of cronyism or judicial favoritism, the court noted that

> [a]llowing sitting judges to preside over cases knowing that their former judicial colleagues will serve as mediators, and earn fees

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6 Edward L. Schnitzer & Hannah Travaglini, "LeClairRyan Bankruptcy Highlights Pass-Through Tax Issue," *The Temple 10-Q*, *available at* www2.law.temple.edu/10q/leclairryan-bankruptcy-highlights-pass-through-tax-issue.

7 *Id.*

8 Andrew Strickler, "Court Scorn for LeClairRyan Deal Is Legal and Personal," *Law360* (Aug. 8, 2023), *available at* law360.com/articles/1708342/court-scorn-for-leclairryan-deal-is-legal-and-personal (subscription required to view article).

9 *Adams v. Tavenner*, Civil 3:22cv237 (DJN) (E.D. Va. Aug. 22, 2023).

10 524 B.R. 689 (Bankr. S.D. Tex. 2015).

11 *In re Smith*, 524 B.R. 689 (Bankr. S.D. Tex. 2015).

for doing so, without the procedural requirements of § 327(a) would eliminate the protection against judicial overreaching. Removing this protection could create a new opportunity for sitting judges to bestow favored positions on friends and former colleagues, evoking the incestuous referee-trustee relationship rampant under the old Bankruptcy Act.

And, as importantly, even if the sitting judge has had nothing to do with the selection of a former colleague as the mediator (as was true in the case at bar), an appearance of cronyism is created: any unsecured creditors hoping to receive even pennies on the dollar for their claims would justifiably be concerned that the premium price the trustee is paying for the ex-judge to serve as the mediator will necessarily mean that fewer dollars, if any dollars, will be distributed to them.

Next, the court provided factors that a judge should consider prior to approving a mediation with the use of estate funds to pay for not only the mediator but also for a trustee's attorney in a bankruptcy setting when evaluating the mediation process. The *In re Smith* court noted 10 factors that should be taken into consideration:

(1) the subject matter of the dispute;

(2) the amount of discovery completed;

(3) the amount of time the attorneys have spent discussing settlement with their respective clients and whether the lines of communication with the clients have been open;

(4) the amount of time the attorneys have spent discussing settlement with opposing counsel, whether the lines of communication have been open, and whether any progress has been made toward a resolution;

(5) the actual courtroom experience of the attorneys in adducing testimony and introducing exhibits;

(6) whether the attorneys have explained the mediation process to their respective clients and reviewed with them the costs of mediation versus the costs of simply going forward with the scheduled hearing or trial;

(7) the name, qualifications and fee of the proposed mediator;

(8) the estimated cost for each client of the mediation (*i.e.*, the client's share of the mediator's fee, the attorney's fees for representing the client in the mediation, and any travel or other associated costs);

(9) the percentage of the estimated cost to the estate (*i.e.*, the estate's portion of the mediator's fee, plus attorneys' fees associated with the mediation, plus costs of lodging and travel, if any) to the actual amount of cash presently in the estate; and

(10) whether any of the parties are opposed to mediation because they want their day in court as soon as possible.

The *Smith* decision points to "'mediation romantics' who believe that mediation best resolves all disputes and leaves all the parties walking away with warm and fuzzy feelings toward one another."[12] Understanding that such judicial skepticism may exist in certain circumstances is critical to any party contemplating using mediation to reach a resolution when the matter is pending before a court.

Mediation: Best Practices

Mediation in bankruptcy cases remains an extremely valuable tool for parties to achieve cost-effective and efficient resolutions. However, the parties in mediation (and mediators) must remember the judiciary's concerns for the fair and equitable administration of justice. The following advice should be taken into consideration when navigating the intersection of private and public interests: (1) Follow the jurisdiction's local rules strictly and completely; (2) disclose the intent to mediate, and highlight the benefits to the key parties involved; (3) when selecting a mediator, be aware of any potential appearance of a conflict of interest or accusations of favoritism that the judge presiding over the litigation could be expected to confront or need to rule upon; (4) analyze the potential costs to the bankruptcy estate; (5) be wary of including a settlement term requiring the court to vacate prior judicial orders; and (6) do not overstep into the court's ability to direct the case before it.

When considering mediation of a matter pending before a court, the parties must do more than consider their own interests and the interests of the other parties. The interests of the judicial system must be considered, too, and addressed as thoughtfully as possible. abi

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12 *Id.* at 705.