Mediation in Insolvency Matters

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INTRODUCTION

A disability to repay what was borrowed is the root cause of any insolvency dispute. This disability could be a result of either circumstances beyond one's control or a wrong decision making in the past, but the endpoint remains constant in all situations. When an insolvency case commences, the creditors compete for the limited pool of assets (estate), which is almost never enough to pay everyone (the common pool problem). Consequently, the debtor is liquidated, which means the end of the business, jobs and tax payments or tax revenue for the State. In terms of negotiation, it does not augur well for any of the stakeholders.

Since the evolution of bankruptcy norms, Courts have been empowered to decide on the disputes of insolvency. In most jurisdictions a separate wing of adjudication (commonly known as Bankruptcy Courts/ Tribunals) has been entrusted the responsibility to surveil the issues in insolvency cases. This is because adjudication ensures equality of the creditors’ claims, fair collection and distribution of the debtor’s assets, and prompt liquidation of the insolvent entity.

However, this perception has changed globally over the past few decades, when more insolvency disputes have been resolved not only by adjudication, but also by Alternative Dispute Redressal (ADR) mechanisms especially, Mediation. Mediation encourages the parties of the dispute to reach an agreement by negotiation and avoid adjudication.

INTERNATIONALLY RECOGNISED FORMS/MODES OF ADR

ADR is a set of methods or techniques that allows parties to a dispute to reach an amicable settlement. It provides for techniques of out-of-court settlement by avoiding lengthy litigation. ADR methods are now widely accepted and have been gaining recognition because of their wide applicability. The application of ADR is different in different jurisdictions due to the existing variations in established legal principles. The methods of settlement that are widely accepted are Arbitration, Mediation, Conciliation and Negotiation. Some aspects of these procedures are presented in table below.

<table>
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<tr>
<th>ADR Methods</th>
<th>Arbitration</th>
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<td>Facilitator, Evaluator</td>
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<td>Legally Binding</td>
<td>Not legally binding</td>
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<td>Level of Confidentiality</td>
<td>Confidentiality determined by law</td>
<td>Confidentiality based on trust</td>
<td>Confidentiality determined by law</td>
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In this context, it would be relevant to have a look at use of ADR mechanism in insolvency disputes in foreign jurisdictions. The same are discussed below.

**United States of America**

In response to the increase in civil disputes and socio-economic changes taking place, Mediation began to be used to resolve community and family disputes in the United States in the 1960s.\(^1\) Though it gained early success, it took a while for it to be used in insolvency disputes. The watershed moment was the Pound Conference, where Harvard Professor, Frank Sander introduced the concept of ‘multi-door courthouse’ and encouraged looking for different dispute resolution methods\(^2\). Instead of walking through the door of a courthouse and commencing adjudication, the parties should look for ‘alternative doors’ which would lead to the same result (resolution of the dispute). He emphasized that there is ‘a rich variety of different processes, which, I would submit, singly or in combination, may provide far more “effective” conflict resolution.’ This quote captures the three basic pillars of ADR:

- Firstly, different ‘doors’ (procedures) offer different dispute resolution mechanisms.
- Secondly, those mechanisms can be used ‘singly or in combination’, meaning that different ADR methods may be used for resolution of the same dispute (and ADR can intertwine with adjudication).
- Thirdly, it must be effective.

ADR (Mediation) in USA was introduced for insolvency cases in 1986, when the Bankruptcy Court for the Southern District of California established the Mediation program. A few years later, Mediation was used in the USA when Greyhound Lines Inc. went bankrupt and set up a pre-reorganisation Mediation plan for thousands of claimants\(^3\) who had brought personal injury and property damage claims against the company in connection with traffic accidents involving Greyhound vehicles. This case is a relevant example of multi-party dispute resolution in which the debtor dealt individually with each creditor.

The ADR procedure in the Greyhound dispute consisted of three separate stages, viz.:

- First, the creditor had to complete a claim form for lost wages, medical bills, and other damages (the ‘offer and exchange stage’).
- Second, the parties negotiated damages. If the creditor refused to participate in this stage or a final decision was not reached, the parties engaged in Mediation for sixty days.
- Third, if the parties failed to reach an agreement, they had to take recourse to arbitration.

Half of the claims were resolved in the first stage\(^4\). This is an example of a win-win negotiation which made it possible to resolve the case promptly, avoid adjudication and litigation costs, reconcile the interests of the parties, and end the dispute peacefully.

Considering the successful examples of ADR, the growing number of bankruptcy cases, and increasing litigation costs, a legal regulation for ADR was established. A major legislative leap towards the use of ADR in insolvency cases was the adoption of the Alternative Dispute Resolution Act in 1998, which required that each federal district court authorise ADR in ‘all civil actions, including adversary proceedings in bankruptcy’\(^5\). For instance, in 2004 the Bankruptcy Court for the District of Delaware established that before certain adversary proceedings, the parties had to attempt to reach an agreement by Mediation. As a result, ADR was used in 60 per cent of reorganisation cases in USA from 2000 to 2011\(^6\).
Mediation in Europe

ADR has gradually become accepted among the European Union (EU) Member States. This contrasts with ADR in the USA, where it emerged not from case law, but through legislation. Several EU Member States have introduced pre-insolvency dispute resolution methods which are primarily aimed at rescuing the debtor. For example, the French Insolvency law provides for two special procedures: the ad hoc mandate and conciliation. In Germany, the insolvency plan procedure enables the debtor and the creditors to conclude an insolvency plan (Insolvenzplan) by negotiation. The Italian insolvency system offers several possibilities to entrepreneurs facing financial difficulties to restructure their debt, all of which are conducted – totally or partially – out of Court.

Dwelling some more on the Italian model, the Italian Bankruptcy Law, (IBL-LeggeFallimentare) currently, provides legal instruments for restructuring, all of which have different characteristics depending on the process, on the degree of Court intervention, and on the applicability of the agreement contents to creditors who do not participate in negotiations. The choice between the different instruments depends on the type of the company, as on the measures needed to keep the business solvent.

The Recovery Plan, ‘piano di risanamento attestato’, is an informal proceeding that can be started by the debtor, when (s)he is in a temporary crisis, through the submission of a plan certified by a qualified professional for debt recovery and for rebalancing the financial situation. The process for negotiating a Recovery Plan is entirely private and confidential; the contractual agreement is binding only upon the creditors involved in the negotiation and does not need a Court approval.

Debt Restructuring Agreement, ‘accordo di ristrutturazione dei debiti’ (according to art. 182-bis, IBL), is a semi-formal (hybrid) proceeding: because the process for negotiating a Debt Restructuring Agreement preserves its private and confidential nature. The agreement is also binding only upon creditors who have participated in the negotiation. The Court takes a more supervisory role in order to control that the legal requirements are met.

The procedure gives the parties considerable freedom in deciding the contents of the agreement, which may consist of simple financial operations such as a rescheduling of payments or debts cancellation; or in a more complex strategy, such as a combination of debt restructuring operations with corporate reorganization measures (e.g. assets sale; substantial financing commitments; merger, or acquisition transactions). However, according to art. 182-bis, IBL, debtors are compelled to respect certain formalities; with regards to the agreement, it has to be signed by the creditors representing at least sixty percent of the debt exposure; the feasibility of the plan for debt recovery must be confirmed by a qualified professional; the agreement should be approved by the Court; the agreement has to be published in the Companies' Register, along with the relevant documentation (art. 161, par. 2, IBL).

Preventive Arrangement with Creditors, ‘concordato preventivo’ (art. 160 et seq., IBL), the proceeding for Preventive Arrangement with Creditors has been significantly amended from 2005 to 2015, whereby the process became the Italian equivalent of US’s Chapter 11.

In a nutshell, the procedure allows the debtor to seek an arrangement with creditors based upon a restructuring plan certified by a professional. The arrangement is submitted to a certain majority of creditors for approval and consists of a wide range of operations in order to satisfy in whole or in part the creditors; including the sale of assets and the allocation of shares or other financial instruments (the so called liquidation agreement). Despite the many legal changes to make the process more flexible and easier than it has been in the past, Preventive Arrangement with creditors remains a judicial procedure.
The Court must examine the petition and, if it concludes it to be complete and compatible with the applicable rules, it admits the debtor to the procedure for Preventive Arrangement with creditors whereby the restructuring plan is negotiated under the control of an appointed judge and a Judicial Commissioner.

The growing use of Mediation in insolvency disputes has been coupled with the need to reduce the number of insolvency cases and ensure stability in the market (the business rescue culture). Insolvency law is one of the key elements for a well-functioning system of civil and corporate law, and it has significant impact on the entire economic structure. In a socio-economic sense, preventing a company from going bankrupt (winding up) when it is facing financial difficulties provides the opportunity to continue employment, efficiently utilise all available sources (natural resources, technical equipment) and preserve relationships, such as with small suppliers of goods and buyers/customers of products and services. In larger insolvency cases where procedures can become more complicated, Mediation can speed up the process and make it more economical, leaving more value in the estate to satisfy the creditors.

In general, Mediation has witnessed a major shift in insolvency disputes over the past few decades. It has become a counterweight to adjudication and has gained recognition as a suitable mechanism for addressing the difficulties of insolvency disputes by allowing the parties to negotiate debt repayment instead of filing a lawsuit.

ADVANTAGES OF ADR ESPECIALLY MEDIATION, IN INSOLVENCY CASES

ADR differs from adjudication. It includes any process designed to resolve a legal dispute voluntarily with third-party assistance and without (significant) involvement of the judiciary. Various forms of ADR exist, but the participation of a third party (a conciliator, mediator, or negotiator) is usually indispensable. The success of resolution of the dispute through ADR depends primarily on the negotiation skills and good faith of the parties. This contrasts with adjudication, where the court conducts proceedings and the litigants must comply with strict procedural laws which may hamper creativity and the effectiveness of dispute resolution.

Firstly, ADR and especially Mediation, increases the likelihood of a win-win scenario and decreases the likelihood of a lose-lose situation. With ADR, both parties satisfy their principal claims by mitigating their demands to some extent (at least in the short term). This is based on negotiations between the parties, supervised by a third party. Negotiations make it possible to ‘separate the people from the problem’ and come to a mutual decision on the problem without (almost) any of the constraints established by law. Adjudication, however, is based upon a ‘winner/loser’ paradigm, meaning that one of the parties ends up losing the case. This can sever commercial relations and trustworthiness between business partners. Sometimes, adjudication results not only in financial, but also psychological stress upon the parties.

Secondly, ultimate resolution of the dispute is not the main goal in some cases. Mediation is often not binding upon the parties without their consent because neither the mediator nor the parties are authorised to resolve the dispute. Some scholars feel that ADR promotes settlement of the dispute rather than reaching an ultimate resolution (like a res judicata decision in court). In other words, Mediation allows the parties to assess their positions and consider the final resolution of the dispute in the future. Even if Mediation fails to bring a settlement immediately, the shift in the parties’ attitudes regarding their own positions can lead to a settlement in the future. Mediation encourages the parties
to bargain and find a mutual solution. In adjudication, a final and binding decision must be rendered in each case. When an insolvency (bankruptcy) case is commenced, it usually results in the winding up of the debtor and triggers the irresolvable common pool problem.

Thirdly, Mediation preserves a ‘normal’ relationship between the parties. It is usually a private procedure rather than a public one, allowing the parties to avoid publicity of the dispute. This is particularly a valuable incentive in business relations (securing commercial secrets and other relevant information). In contrast, all disputes that require adjudication become public (except in select cases), and the court, as a general rule, has to allow public access to proceedings.

Fourthly, Mediation is flexible—it allows the parties to reach an agreement through persuasion and promotes ‘party-driven solutions’. The parties can decide upon the procedural and substantive rules of dispute resolution. In adjudication (especially with insolvency cases), the parties are bound by strict procedural rules from which no derogation is permissible. The rules for civil (insolvency) proceedings may decrease the effectiveness of fast dispute settlement.

Overall, Mediation makes it possible to avoid some of the inherent shortcomings of adjudication (e.g., cost, publicity, lack of flexibility) in insolvency disputes. This is valuable because the debtor’s assets are not wasted on litigation, and other costs. The commencement of an insolvency case reveals the debtor’s problematic financial situation and hinders business. Mediation provides strong incentives for both parties to engage in fast and efficient dispute resolution and look for a common business solution.

INDIVIDUAL AND COLLECTIVE INTERESTS IN INSOLVENCY DISPUTES

Insolvency (bankruptcy) cases are collective proceedings in which numerous persons (the debtor, secured and unsecured creditors, a bankruptcy administrator (trustee), co-obligators, etc.) participate. There is, therefore, a dilemma of how ADR can reconcile the interests of all the creditors. Should each creditor participate in the ADR procedure? What effect does the agreement between the debtor and some of the creditors have on all the creditors?

The unique feature of ADR in insolvency cases is that not all the creditors usually participate in the dispute resolution. In contrast to insolvency adjudication, the debtor usually resolves the dispute with the principal creditors (who are likely to initiate insolvency proceedings), and a formal insolvency case is not initiated. For instance, in the USA, ADR is utilised in three contexts for insolvency disputes:

- to resolve disputes and achieve a consensus with respect to plans for reorganisation;
- for single creditor disputes; and
- for multiple-creditor claims of the same nature.

The debtor can negotiate with each creditor individually (like in the Greyhound case), or with a group of creditors to come to a collective agreement. This situation is defined as a ‘cramdown’. A cramdown is the judicial power to confirm or amend a plan even against the wishes of certain creditors. Thus, when a debtor comes to an agreement with some creditors, the other creditors cannot challenge the agreement and must comply with it.

However, a cramdown is only possible in court-supervised ADR. If the court is not involved in the ADR (at least in the confirmation of an agreement between the parties), a cramdown is not possible, and thus has no effect over the creditors who did not participate in the ADR procedure. In other words, if the peaceful settlement ending the dispute is not confirmed by the court, it does not have effect over
the creditors who are not parties to the agreement.

MEDIATION AS AN EFFECTIVE ADR TOOL IN INDIA

In modern times to keep pace with the globalisation of commerce, the Government of India has taken several legislative measures to promote Mediation in the country. For instance:

• Section 442 of the Companies Act, 2013, which provides for referral of company disputes to Mediation by the National Company Law Tribunal (NCLT) and Appellate Tribunal read with the Companies (Mediation and Conciliation) Rules, 2016 (notified on September 9, 2016).

• Section 12A of the Commercial Courts Act, 2015 provides for Pre-Institution Mediation in commercial disputes.

• Section 32(g) of the Real Estate (Regulation and Development) Act, 2016, (RERA) provides for amicable conciliation of disputes between the promoters and allottees through dispute settlement forum set up by consumer or promoter associations.

• Section 37 and section 74 to 81 of the Consumer Protection Act, 2019 (which replaced the Consumer Protection Act, 1986) provides for reference of a dispute to Mediation as an ADR Mechanism and setting up of a Consumer Mediation Cell at each of the District Commissions, the State Commissions and National Commission.

• Section 18 of the Micro, Small and Medium Enterprises (MSME) Development Act, 2006 mandates conciliation when disputes arise on payments to MSMEs.

• Section 4 of Industrial Disputes Act, 1947 authorises the appropriate government to engage such number of persons as may be deemed necessary by notification in the Official Gazette as conciliation officers, for discharging the responsibility of mediating in and promoting the settlement of industrial disputes. Section 12 of the Industrial Disputes Act, 1947 provides duties of conciliation officers.

As of now Mediation has not been utilised for resolving of insolvency disputes. Currently insolvency disputes are resolved under the Insolvency and Bankruptcy Code, 2016 (IBC). Before the enactment of the IBC, there was no single legal framework in India that dealt with insolvency and bankruptcy. The provisions relating to insolvency and bankruptcy were scattered over many legislations like Sick Industrial companies (Special Provisions) Act, 1985 (SICA Act); The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 and the Companies Act, 2013 etc.

Performance of IBC

The IBC has proved to be a landmark legislation that has produced potent outcomes in a short span of four years. According to the Reserve Bank of India, the recovery of stressed assets through the IBC route was nearly forty two percent as against an average of ten percent under the earlier methods to recover debts such as SARFAESI Act and Debt Recovery Tribunals (DRTs). The IBC has helped resolve some of the large non-performing asset (NPA) cases such as Bhushan Steel Ltd., Alok Industries Ltd., Essar Steel India Ltd., etc, recouping lakhs of crores of rupees back into the system. As of March, 2020, 3774 corporate debtors (CDs) have been admitted in the IBC process and of them 1135 have exited through resolution plans or liquidation. 221 CDs that have been resolved under the Code with creditors having recovered Rs. 1.84 lakh crore which is about 191 per cent of the liquidation value of those CDs. The Code has brought about a significant change in the behaviour of debtors and creditors
alike. Thousands of debtors are settling their debts at early stages of defaults, on receipt of notice for repayment, before and even after admission of CIRP to avoid the consequences of the IBC process. Creditors are initiating CIRP at the early stages of default, avoiding ballooning up of unpaid debts.

While the Code has performed well over the last four years, there is still scope for improving outcomes under it. Time taken in concluding a CIRP has been a matter of contention and debate. According to the statute, the entire process of corporate insolvency should not take more than a period of 330 days (from earlier 270 days)\textsuperscript{17} in total, but it is seen that this time period has been exceeded in quite a number of cases due to practical difficulties. However, on an average, as of March, 2020, the time for completion of a process under IBC has hovered around 375 days for resolved cases and 309 days for liquidation cases. These timelines can be reduced further.

The Code has emerged successful in the face of numerous challenges over the past four years. The COVID-19 pandemic has posed a new challenge to the Code. Businesses have suffered tremendously on account of demand and supply chain disruptions and receding sales and revenue caused by the pandemic and the nationwide lockdown. In these trying times, if a firm does default and is pushed into insolvency proceedings, the chances of resolution are bleak as there may not be enough resolution applicants in the market to provide resolution plans. Thus, to prevent many businesses who are reeling under pandemic induced financial stress, especially MSMEs, from being pushed into insolvency, the Code has recently been tweaked to address this challenge. The threshold for initiating insolvency against a defaulting company has been increased from 1 lakh to 1 crore. Further, the provision of section 7, 9 and 10 of the IBC have been relaxed by insertion of section 10A which reads as under:

\textbf{10A. Suspension of Initiation of corporate insolvency resolution process.-} Notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after March 25\textsuperscript{th}, 2020 for a period of 6 months or such further period, not exceeding one year from such date, as may be notified in this behalf:

Provided that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period.

Explanation. - For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply to any default committed under the said sections before March 25\textsuperscript{th}, 2020.

With the Code suspended for a period of six months, extendable by another six months, the opportunity is ripe to innovate and explore new ways of resolving disputes. Special out-of-court procedures such as Mediation can be explored. Mediation can help reduce the burden of increasing cases on the already over-burdened judiciary. In the context of the IBC, the Minister of State for Finance and Corporate Affairs, Shri Anurag Singh Thakur said in a written reply to the Rajya Sabha, ‘As per the data provided by National Company Law Tribunal (NCLT), total 19,771 cases were pending with NCLT benches as on September 30, 2019, which include 10,860 cases under Insolvency and Bankruptcy Code (IBC), 2016’. This reflects pending court-delays which can pose a setback to the outcomes of the Code that have been achieved so far.

Mediation can be a viable option in a country like India, where the population is enormous, and wealth is not equally distributed. It is an informal process that comes to an end in a few sittings and is very cost efficient compared to the formal process in the courts of law. Mediation has already been implemented
by the judiciary in cases of family and property disputes. This is because the focus of Mediation is on finding solutions that will resolve the concerns of both the parties concerned and parties are free to make their own decision. There is no blame game in a Mediation process. It is a voluntary process and the duty of the mediator is to bring the parties to a mutually agreed solution. Despite being beneficial, Mediation is still struggling in becoming a choice over litigation. On the contrary, in the USA, Mediation has proven to be in frequent use. In fact, court-ordered Mediation in the USA has been very successful in some of the most significant bankruptcy cases, such as Lehman Brothers\textsuperscript{18}, etc. and it is time that India should also try and resort to Mediation for the purposes of the corporate insolvency resolution process. Online Mediation has also gained popularity, allowing parties to reach a solution on virtual platforms on real time basis. This can prove to be particularly useful in the current scenario of the COVID-19 pandemic as the world is shifting to online platforms to maintain social distancing. E-Mediation is being resorted to in many cases. It may be noted that CJI Hon'ble Mr. Justice S. A. Bodbe, in an interview with Economic Times in November, 2019 has emphasised on the importance of Mediation as an ADR mechanism and observed that all (commercial) matters could be made to first go through pre-litigation Mediation\textsuperscript{19}.

As IBC is a new statute, the experience during its implementation has led us to correct its infirmities over the last couple of years and the jurisprudence on the subject is evolving. Since the IBC lacks provisions for special out-of-court structuring mechanisms such as Mediation, the stakeholders are forced to choose the only default option which is open to them i.e. a formal insolvency resolution procedure. In view of the aforesaid arguments for Mediation, perhaps it is time that the Code may suitably incorporate the same, acting as the link between a formal and an informal insolvency resolution process. Experience has shown that an informal procedure that is recognised by legislation gains more acceptance amongst the stakeholders. Amendments may be considered in the statute in order to inculcate the healthy, inexpensive, and fast practice of Mediation within insolvency process to the extent feasible. This hybrid structure comprising of both formal and informal method of resolution, would help in not only reducing the burden upon the courts/tribunals but save time and money of the stakeholders, as well.

The objective of the Code is to save the life of a distressed company. The Code in tandem with mechanisms such as Mediation, can achieve this objective more efficiently and effectively. The present scenario of the COVID-19 pandemic necessitates Mediation between parties so as to enable quick resolution of disputes. This mechanism can prove to be useful even in the post COVID-19 pandemic scenario to deal with the problem of debt-overhang especially individual financial distress resulting from the crisis. With technology developing at a fast pace, e-Mediation has the potential to pick up in the near future. As envisioned, Mediation coupled with formal insolvency procedure can become the go-to-option for stakeholders, enabling dispute resolution across cultures, jurisdictions and borders.
NOTES


3 Ibid.


10 Ibid.

11 Ibid.


14 Supra Note 1.


19 Ajmer Singh (2019), "Commercial Disputes should go through Mediation first: Bobde", Economic Times, 14 November.