Pros & Cons

of Pre-Discovery Mediation in Mega Bankruptcy Adversary Proceedings

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A 10-figure bankruptcy demands innovative approaches to case management and court administration, especially where large numbers of adversary proceedings are expected. One trend in recent cases—pre-discovery mediation—is proving successful in that regard, although it does have potential pitfalls of which litigants should be wary.

In 2020, 60 companies filed mega bankruptcies,[1] the highest number of such cases in the period from 2005 to 2020.[2] In bankruptcy megacases, a substantial number of adversary proceedings with avoidance claims are often filed to claw back funds into the estate. With the costs of discovery rising in litigation, estates must cost-effectively handle case management. Effective measures and protocols are often put in place to efficiently manage the case volume and reduce litigation costs to promote and encourage resolution.

What procedures have courts applied to relieve the estate from these challenges in bankruptcy megacases? This article looks at the measures implemented by courts in four recent cases, evaluates the pros and cons of the protocol procedures, and concludes with an overall assessment of whether these procedures are successful in resolving matters without further litigation.

Generally, in orders governing adversary procedures, Bankruptcy Courts use mandatory or optional pre-discovery mediation to reduce the estate's burden and bring speedy and cost-effective outcomes for all parties. Most adversary procedures will stay discovery until mediation is complete and determined unsuccessful. Not all mediations are alike. While courts often utilize the measures of stay in discovery and some form of pre-discovery mediation, the protocols

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can be considerably different. Excerpts from four recent adversary proceedings illustrate how the courts have uniquely implemented mandatory, or optional, pre-discovery mediations.

In re Health Diagnostic Laboratory, Inc.[3] In an Amended Procedures Governing Avoidance Action Adversary Proceedings,[4] the court ordered that the procedures apply to *all* avoidance actions that the liquidating trustee has filed and *will file*. In additional to the stay of formal discovery, "hearings on all motions, including but not limited to initial motions responsive to the Complaint, such as Rule 12 motions, shall not be noticed or convened until conclusion of the Mediation Process."[5]

Health Diagnostic Laboratory proceeded in a unique way because the court stayed not only discovery but also all motions practice. So, while the court did not preclude initial motions responsive to the complaint, hearings on initial motions would not be noticed or convened until after the parties conclude mediation.

In re LeClairRyan PLLC.[6] In an Order Approving Procedures and Permitting Trustee to Prosecute and Compromise FAO Actions,[7] the court granted a procedure requiring that a "one hundred and twenty (120) day period commencing with the filing of the Complaint (the "Settlement Period") shall be used by the Trustee to pursue settlement of the claims and commence mediation (if required as set forth below). Unless otherwise ordered by the court, *the parties' obligations to conduct formal discovery* in each FAO Adversary Proceeding *shall be stayed during the Settlement Period*, provided that the stay of discovery shall in no way preclude the parties from informally exchanging documents and information in an attempt to resolve an FAO Adversary Proceeding [emphasis added]." This settlement period to allow for mediation was common in most adversary procedures.

Unlike *Health Diagnostic Laboratory*, the *LeClairRyan* court required the parties to file only an answer. The order stated that in motions affecting all FAO adversary proceedings, "The summons issued for each FAO Adversary Proceeding will vary from the Court's standard form and will be an 'Answer Only' summons. The summons will inform the defendant that he/she/it has thirty days from the date of service of the summons (rather than the date of issuance) to respond to the complaint."[8] In other words, the order curtailed the defendant's right to file a motion to dismiss immediately in response to the complaint. This meant that even if some claims were without merit, the defendant had to incur the cost of a mandatory mediation process before it could file a motion to dismiss.

In re Astria Health.[9] In an Order Granting Motion for Order Establishing Procedures Governing Adversary Proceedings Pursuant to Section 502, 547, and 550 of the Bankruptcy Code,[10] the court did not require mandatory mediation. Instead, the court noted that "[i]f the Parties jointly agree in writing (which writing shall be filed in the adversary proceeding) to enter Mediation (defined below) prior to the Response Due Date, the Response Due Date shall be deferred while Mediation is pending. If the Mediation does not resolve the Avoidance Action, the Response Due Date shall be extended for an additional thirty (30) days following the completion of Mediation and the filing of the mediator's report...." Furthermore, the court ordered a "Stay of Requirement to Conduct Rule 26(f) Conference," as well as a stay of discovery.

In this order, the court provided a middle ground between *Health Diagnostic Laboratory* and *LeClairRyan*. Even if the parties chose to participate in mediation prior to filing a responsive pleading, they would still be permitted to file an initial motion or an answer. It also reduced costs by allowing the parties to participate in mediation prior to incurring the costs of preparing and filing responsive pleadings.

In re Southern Foods Group LLC.[11] In an Order Establishing Procedures Governing Certain Adversary Proceedings Commenced by the Debtors pursuant to 11 U.S.C. §§ 547, 548, 549, and 550,[12] the court gave defendants "sixty (60) days following service of this Order *to opt into* the Scheduling Order with Voluntary Mediation Program [emphasis added]." For the defendants who decided to opt into the voluntary mediation program, the court gave the following

scheduling order: "Extensions to Answer or File Other Responsive Pleading to the Complaint"; "Stay of Discovery"; and "Mediation."

Here, similar to *Astria Health*, the court ordered that if the defendants chose to opt into the mediation program, "[t]he fees and cost of the Mediator shall be paid by the *Plaintiff*... [emphasis added]." In many cases, the mediation fees are shared between the plaintiff and the defendant. This protocol encouraged defendants to voluntarily take the pre-discovery mediation route by placing the cost burden entirely on the plaintiff.

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Analysis

In all four of these cases, the Bankruptcy Courts ordered mandatory pre-discovery mediations (or an option to participate in pre-discovery mediation) in the adversary proceedings. While the protocols differed in each case, the pre-discovery mediation benefited the parties in two common ways.

First, the mediations unquestionably provided cost savings to the estates. As noted earlier, estates in bankruptcies cannot afford to waste money in full-blown litigation processes, including initial motions practice or formal discovery, for hundreds of adversary proceedings. Thus, measures like pre-discovery mediation help estates save money.

Second, a mediation allows the parties to fast-track resolution. For instance, in the *Health Diagnostic Laboratory* case, most of the adversary proceedings filed were settled through mediations, and the liquidating trustee was thus spared the time and expense of an extensive discovery process for the more than 1,400 matters filed.

However, while it is undeniably true that the mediations help to cost-effectively resolve matters, pre-discovery mediations present other challenges. Most defendants need to conduct discovery to better position themselves in a case. While most of the protocol procedures do not limit informal discovery, it may prove difficult to obtain information that is within the possession of the estate that would support low- or no-liability outcomes for defendants. As a result, many defendants feel handcuffed by these procedures, and mediations may feel like a "shakedown."

Another challenge for defendants is whether the protocols limit responsive pleadings initially to answers only. In scenarios where a defendant may want to file a motion to dismiss, it is forced to file an answer and participate in pre-discovery mediation before being allowed to file a motion to dismiss. This process could create more defense costs. Moreover, protocol procedures are often approved by the Bankruptcy Courts before all defendants are even named in adversary proceedings. So, unfortunately, defendants named in complaints filed after the approval of these procedures do not have an opportunity to timely object or the ability to shepherd a different process.

Conclusion

Mandatory or optional pre-discovery mediation is a valuable tool Bankruptcy Courts can utilize in the adversary proceedings. Pre-discovery mediation saves money and time, both elements that are particularly important to the parties in bankruptcy cases. Most importantly, those who have participated in mandatory pre-discovery mediation processes agree that the procedures are effective tools.

Because the Bankruptcy Courts commonly utilize mandatory or optional pre-discovery mediation in mega bankruptcy cases, it is important for the parties in the adversary proceedings to anticipate and prepare for the mediation. As seen in the four cases discussed, Bankruptcy Courts can use a variety of protocols to implement the pre-discovery mediations.

While at first glance these protocols may appear rigid, there are usually built-in flexibilities available depending on the language of the orders. For instance, in *LeClairRyan, PLLC,* the court said in its order, "No term of the Motion or this Order shall prohibit the Trustee from seeking specific Court approval that the procedures shall not apply to any individual defendant."[13] That said, parties need to be cognizant of the differences in the protocols. It is prudent to engage attorneys who are familiar with the procedural preferences specific to each court and individual bankruptcy judges. J

[1] A "mega bankruptcy" refers to a filing in which the contested amount is over $1 billion in reported assets. Cornerstone Research, Trends in Large Corporate Bankruptcy and Financial Distress, Midyear 2021 Update, cornerstone.com/wp-content/uploads/2021/12/Trends-in-Large-Corporate-Bankruptcy-and-Financial-Distress-Midyear-2021-Update.pdf#:~:text=The%20COVID%2D19%20pandemic%20triggered,since%20the%20global%20financial%20crisis.&text=Bankruptcy%20filings%20by%20private%20companies,37%25%20for%202005%E2%80%932020.

[2] *Id.*

[3] *In re Health Diagnostic Laboratory, Inc.,* Case No. 15-32919-KRH (Bankr. E.D. Va., May 30, 2017).

[4] Case No. 15-32919-KRH, ECF No. 2740.

[5] *Id.* at 8.

[6] *In re LeClairRyan PLLC,* Case No. 19-34574-KRH (Bankr. E.D. Va., June 15, 2020).

[7] Case No. 19-34574-KRH, ECF No. 533.

[8] *Id.* at 4.

[9] *In re Astria Health*, Case No. 19-01189-11 (Bankr. E.D. Wash., May 24, 2021).

[10] Case No. 19-01189-11, ECF No. 2549.

[11] *In re Southern Foods Group, LLC,* Case No. 19-36313 (Bankr. S.D. Tex., Apr. 20, 2021).

[12] Case No. 19-36313, ECF No. 3646.

[13] Case No. 19-34574-KRH, ECF No. 533 at 2.