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# Bankruptcy mediation – Is it a trap for the unwary state court practitioner?

MEDIATION IN BANKRUPTCY AND NON-BANKRUPTCY PROCEEDINGS ARE DIFFERENT ANIMALS

"Let's mediate!" has become a catchphrase in bankruptcy cases nationwide as bankruptcy is becoming a more common tool for addressing mass-tort claims. Mediation in bankruptcy and non-bankruptcy proceedings are different animals. State-court practitioners will better represent their clients by understanding mediation's role in a bankruptcy case and how it differs from their regular mediation experience.

Bankruptcy mediation is inherently multi-party, often involving complex issues of asset and claims valuation and confirmation of a reorganization plan. Unlike standard civil litigation, which is typically bilateral, bankruptcy encompasses numerous stakeholders and intensive judicial supervision. Courts have embraced mediation as an efficient and critical tool in managing large, contentious bankruptcy cases.

## Mediation parties in bankruptcy

Unlike typical two-party civil disputes, bankruptcy proceedings bring together a broad spectrum of stakeholders, necessitating a highly coordinated and court-supervised mediation framework. ["Chapter" cited herein refers to the chapters of U.S. Code: Title 11-Bankruptcy.]

***Debtors*** – Debtors, who may be individuals or entities, may be debtors-in-possession, managing the reorganization under Chapter 11.

***Trustees*** – Trustees act as fiduciaries for the bankruptcy estate. Their role includes liquidating assets (Chapter 7) or managing reorganization (Chapter 11). In a Subchapter V case under Chapter 11, the trustee's duties include facilitating the development of a consensual plan. (11 U.S.C. § 1183(b)(7).)

***Unsecured and secured creditors*** – Secured creditors have property securing their claims; unsecured creditors do not have any security. Secured creditors have a superior bargaining position because they must be, according to the Bankruptcy Code, "adequately protected." Their differing legal rights lead to varied priorities in negotiation – secured creditors seek collateral preservation and foreclosure, while unsecured creditors seek maximum estate recovery.

***Equity holders*** – Equity holders rank below creditors in priority. Nonetheless, those who are officers or directors may have indemnity claims in equal priority with unsecured creditors. Although equity interests are subordinated to creditors' claims, they may, if they are also managers, influence mediation.

***Creditors committees*** – Appointed under 11 U.S.C. section 1102, these committees represent the collective interests of unsecured creditors and typically retain advisors who participate actively in mediation.

***Tort claimants*** – Tort claims raise unique challenges, necessitating specialized mediators. In mass-tort cases, the plaintiffs typically are unsecured and must establish the value of the unliquidated tort claims. In mass-tort cases, the Office of the United States Trustee often appoints a committee of tort claimants. Plaintiffs' counsel who do not have clients on a committee may align as an ad hoc committee to appear in the case and to participate in mediation.

***Insurers*** – Insurers are key stakeholders. Their coverage obligations and policy limits are central to settlement negotiations. Disputes over policy interpretation, allocation of claims, and bad faith add further complexity to mediation.

Given this array of participants, bankruptcy mediation typically unfolds in multiple phases, often governed by court-approved mediation protocols. These protocols establish procedural rules, confidentiality protections, the scope of mediator authority, and methods for engaging different parties at various stages, e.g., separate caucuses and staged settlement discussions.

A critical distinction between mediation in bankruptcy and mediation outside of bankruptcy is the absence of a purely adversarial structure. While some parties are directly opposed (e.g., debtors vs. creditors), others may share overlapping interests. All negotiations must occur within the constraints of the Bankruptcy Code, which imposes specific distribution priorities, procedural safeguards, and court oversight. For instance, any mediated settlement must ultimately receive judicial approval and be consistent with the principles of fairness and equitable treatment under bankruptcy law. If the settlement is part of a reorganization plan, the Bankruptcy Court must also make detailed findings of fact and law to confirm the plan.

In sum, bankruptcy mediation is a hybrid legal process that blends traditional dispute resolution with extensive judicial oversight. Its success hinges on structured negotiation, stakeholder inclusion, and alignment with the overarching goals of the bankruptcy system: fairness, efficiency, and preservation of assets and going concern values. In contrast, non-bankruptcy mediation is typically between two parties with minimal judicial involvement.

## Confidentiality in bankruptcy mediation

Confidentiality is a foundational principle of mediation, promoting the open exchange of information. In bankruptcy mediation, however, confidentiality is more complex due to the overlay of procedural transparency, statutory obligations, and multi-party interests.

Confidentiality in non-bankruptcy mediation is widely recognized as one of the essential pillars supporting the effectiveness of alternative dispute resolution (ADR). Compared to bankruptcy mediation, confidentiality protections in non-bankruptcy mediation are often more comprehensive.

Many states have enacted ADR statutes that explicitly safeguard mediation confidentiality, including the Uniform Mediation Act (UMA). California has not adopted the UMA. Under California law, virtually everything said or written in connection with a mediation is confidential and inadmissible – even if relevant to prove misconduct, malpractice, or breach of duty. (See Evid. Code, §§ 1115-1129 [mediation communications are inadmissible and non-discoverable].)

The confidentiality afforded in non-bankruptcy mediation often contrasts sharply with the more limited confidentiality available in bankruptcy, where judicial oversight, creditor notice, and estate administration require

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disclosure of settlement terms. In non-bankruptcy settings, there is no equivalent to Bankruptcy Rule 9019, which requires Bankruptcy Court approval of settlements, or the confirmation requirements of Bankruptcy Code section 1129 that might necessitate public disclosure of mediation outcomes. Confidentiality in bankruptcy mediation is shaped by a multilayered framework that includes both general mediation law and bankruptcy-specific rules:

- Federal Rule of Evidence 408 prohibits the admission of statements made during settlement negotiations. While not specific to bankruptcy, Rule 408 sets a baseline of protection for mediated discussions.
- Local bankruptcy rules and mediation programs often include express confidentiality provisions. These rules may specify, for instance, that no communication made during mediation may be disclosed in court, and mediators cannot be compelled to testify about the proceedings.
- Court orders, particularly mediation orders, frequently define the scope and limitations of confidentiality on a case-by-case basis. These orders can tailor confidentiality protections to suit the complexity and public interest involved in a particular case.

Bankruptcy is inherently a public process. Stakeholders who are not present in mediation may still have a legitimate interest in the outcome of mediated settlements, especially if those outcomes impact treatment of claims under a plan. As parties in interest, these stakeholders have a right to be heard on the Bankruptcy Court's review of a mediated settlement.

Therefore, absolute confidentiality is rarely possible in bankruptcy mediation. Specific limitations include:

***Disclosure and approval requirements*:** Under Federal Rule of Bankruptcy Procedure 9019, any settlement or compromise of a dispute that affects the bankruptcy estate must be disclosed and approved by the court. This ensures transparency and protects the interests of creditors and other parties. Bankruptcy Rule 2002(a)(3) further requires that notice of the proposed settlement be provided to parties in interest.

***Impact on plan confirmation*:** When the mediated outcome materially affects the structure or viability of a Chapter 11 plan, the court may require the filing of term sheets, or even partial disclosure of the mediation record to evaluate compliance with confirmation standards under Bankruptcy Code sections 1122, 1123, and 1129.

***Mediation-status reporting*:** Courts may direct mediators to submit status updates. In many cases, the mediator's status report may affect the Bankruptcy Court's consideration of whether the case should be converted to Chapter 7 or dismissed.

Given these competing forces, courts and practitioners must balance the benefits of confidentiality with the need for disclosure and fairness in bankruptcy. Best practices often include:

- Structuring mediation orders to clearly define what is confidential, who is bound by confidentiality, and how exceptions (such as court approval) will be handled;
- Using redacted or sealed filings when submitting settlement agreements containing sensitive information;
- Ensuring informed consent of all mediation participants about the scope of confidentiality;
- Limiting confidential settlement terms only to those elements that do not impact estate distributions or third-party rights.

Ultimately, confidentiality in bankruptcy mediation exists within a broader judicial context that prioritizes procedural fairness, creditor notice, and the integrity of the reorganization process.

## Role of the court in bankruptcy mediation

In non-bankruptcy contexts, mediation is often voluntary, though some jurisdictions mandate it for certain types of claims. The scope and procedure are often dictated by local court rules or party agreement.

Typical parties in non-bankruptcy mediation include: (1) Plaintiffs and defendants, (2) Insurance adjusters or corporate representatives, (3) Counsel for each side, and (4) Occasionally, experts or neutral evaluators. Unlike bankruptcy mediation, which typically seeks a settlement that involves numerous parties with different parochial interests (e.g., vendors, employees, tort claimants, bondholders and institutional lenders), non-bankruptcy mediation typically involves a dispute that is between only two opposing parties.

Bankruptcy judges maintain a hands-on role in mediation, more so than in typical civil litigation. Their responsibilities include:

- Referring disputes to mediation; sometimes mandatorily and approving mediation protocols;
- Selecting mediators from court-approved panels or slates proposed by participants; the court's involvement can add legitimacy and structure but may also raise concerns about judicial neutrality if not properly compartmentalized. This concern is especially noteworthy when the mediator is a sitting or recently retired bankruptcy judge;
- Monitoring the mediation's progress via status conferences;
- Enforcing settlements under Bankruptcy Rule 9019;
- Using mediation outcomes to inform plan feasibility and good faith under 11 U.S.C. § 1129.

## Role of insurance companies in mediation

In mass-tort bankruptcies, insurers often determine the financial feasibility of the debtor's reorganization. In *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc.* (2024) 602 U.S. 268, the Supreme Court held that insurers are "parties in interest," thereby entitling them to be heard on any matter in the case including discovery, claim objections, coverage disputes, the assignability of insurance rights to a settlement trust and plan confirmation. Therefore, bankruptcy courts often appoint insurance mediators, sometimes alongside general case mediators. Examples of special insurance mediators include the Archdiocese of San Francisco, the Archdiocese of New

Orleans, the Diocese of Rockville Centre and the Boy Scouts of America. *Truck Insurance* has redefined and enlarged insurer rights in mass-tort bankruptcies and the mediation of those cases.

In traditional civil litigation, insurers play a central but more focused role. In both bankruptcy and non-bankruptcy cases, they are governed by state insurance laws and general civil procedure. However, the multi-party complexities of bankruptcy cases, the treatment of insurance policies and rights under a reorganization plan and the possibility of court-approved buybacks of insurance policies provide the insurers with a substantively different role than they have in two party disputes.

### Mediator qualifications and selection

The selection and qualifications of mediators provide some contrast between bankruptcy and non-bankruptcy cases. In bankruptcy, court involvement is more active due to the need for oversight of multi-party fairness and procedural integrity. In non-bankruptcy, the process is more flexible and often party driven.

Non-bankruptcy mediators generally are chosen by the parties' agreement and the court rarely forces a particular mediator on the parties. Since the non-bankruptcy dispute is not in a specialized forum that is designed to protect non-parties to the mediation, specific knowledge of the court's procedures typically is not relevant to the mediator selection process.

Bankruptcy mediators must be appointed by the Bankruptcy Court (and often are selected by the Court outside of a slate proposed by the parties) and their compensation is subject to Bankruptcy Court approval. Mediators must understand that the Bankruptcy Code can provide unique settlement mechanisms and must have experience in multi-party negotiations. Commonly, parties other than the debtor and the creditors committee, e.g., the secured creditor, the insurer or the U.S. Justice Department's Office of the United States Trustee, are heard by the bankruptcy court on the identity and qualifications of the mediator.

### Approval of mediated settlement

A significant difference between bankruptcy and non-bankruptcy mediation is the process for approving a mediated outcome. Under Bankruptcy Code section 1129(a)(3), a Chapter 11 reorganization plan must be proposed "in good faith and not by any means forbidden by law." This requirement serves as a safeguard against abusive or manipulative use of the bankruptcy process. Courts interpret "good faith" broadly, evaluating the totality of the circumstances, including the debtor's conduct throughout the case and particularly during the plan negotiation process. One critical lens through which courts assess good faith is the debtor's participation in mediation. On the other hand, the two-party nature of non-bankruptcy mediation does not entail the same level of court intervention in the approval of a settlement.

Bankruptcy courts often view active and meaningful participation in court-approved mediation as a strong indicator of a debtor's good faith. This is especially true in cases involving contentious claims or large, diverse creditor bases, where traditional bilateral negotiations are likely to fail. When a debtor engages in mediation in a timely manner, adheres to court-imposed protocols, and cooperates with the mediator, it suggests a genuine effort to resolve disputes and build consensus rather than delay proceedings or impose a one-sided plan.

Another hallmark of good faith is the inclusion of all major stakeholder groups in the mediation process. This encompasses not only secured and unsecured creditors but also equity holders, tort claimants, governmental agencies, and other parties with a substantial interest in the case. Failure to involve key constituencies – or selectively excluding parties likely to object – can be interpreted as strategic behavior designed to manipulate voting outcomes or suppress dissent. Conversely, broad stakeholder engagement fosters transparency, promotes equitable treatment, and increases the likelihood that the plan reflects a legitimate, negotiated compromise. Courts will closely scrutinize whether the mediation process was used to foster a fair and open dialogue or was instead weaponized to intimidate or marginalize dissenting parties.

Often, the mediated outcomes become integral components of the reorganization plan. When these settlements emerge from a court-supervised mediation process and are supported by multiple constituencies, courts are inclined to view them as evidence that the plan was formulated in good faith. Such embedded agreements signal that the plan is the product of compromise rather than unilateral imposition.

Mediation plays a substantive and evidentiary role in the bankruptcy court's good faith analysis under section 1129(a)(3). While successful mediation is not dispositive, it is often highly persuasive evidence that a plan was proposed with a genuine intent to reorganize, resolve disputes fairly, and comply with the spirit and letter of the Bankruptcy Code. On the other hand, misuse or abuse of the mediation process can significantly detract from a finding of good faith and jeopardize plan confirmation.

### Conclusion

Mediation is a powerful dispute-resolution tool in both bankruptcy and non-bankruptcy proceedings. However, it functions differently due to the distinct legal frameworks, party structures, confidentiality expectations, and judicial roles governing each context.

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