Insolvency proceedings of tomorrow

Prof. Tuula Linna examines the future of Alternative Dispute Resolution (ADR), Design Thinking and Sustainability in insolvency proceedings

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The notion that procedural law embodies a formal law that drags slowly, trying to comply with social development and value changes, only being renewed under duress when resources are reduced, is probably right, but also wrong.

Litigation law does move slowly and resists change, but this rigidity is offset by alternative dispute resolution (ADR) which supplements and enriches traditional adversarial legal procedures. Regarding insolvency proceedings, much has changed in the European legal system. The new European Insolvency Regulation (recast EIR) has been applicable since last summer, and the EU Commission's proposed restructuring Directive, COM(2016) 723 final, is subject to discussions within the Council and its preparatory bodies.

So far, the main focus has been on how to develop insolvency proceedings themselves. Some attention has also been paid to ancillary proceedings which derive directly from insolvency proceedings and are closely linked with them, such as avoidance actions (see Articles 6 and 16 of the recast EIR). However, the normal civil disputes that fall within the scope of the Brussels I Regulation have not been the subject of discussions in the insolvency context. Such disputes may concern, *inter alia*, the existence or amount of a creditor's receivables, property belonging to the estate or allowance disputes among a group of companies.

As an ineffective and outdated dispute-resolution system might impede even the most-refined insolvency proceedings, a well-founded question is whether insolvency regimes have caught up with the development of ADR processes. An evident progression from liquidation to restructuring proceedings has taken place, but how about the transition from adversarial litigation to ADR in insolvency-connected civil disputes?

Modern developments in the ADR field have led to procedural design with combinations of different kinds of ADR processes. From China to the US, mediation-arbitration (Med-Arb) systems, with many variations, have been in use for decades. Even if there are problems, especially regarding confidential

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information in systems with only one neutral party, benefits also seem to be evident. The Declaration of Policy in the US Alternative Dispute Resolution Act of 1988 puts it beautifully:

> *"[A]lternative dispute resolution, when supported by the bench and bar, and utilizing properly trained neutrals in a program adequately administered by the court, has the potential to provide a variety of benefits, including greater satisfaction of the parties, innovative methods of resolving disputes, and greater efficiency in achieving settlements."*

In that light, the legislation gives authority to each US district court to use ADR in all civil actions, including adversarial bankruptcy proceedings (see also 28 US Code §651).

In Europe, we could advance in the same direction – and go even further – by extending ADR to pre-insolvency proceedings, collective insolvency proceedings as well as ancillary and non-ancillary insolvency-connected disputes. For example, mediation, based on expert evaluation, in which the parties have not revealed confidential information in *ex parte* discussions, might not necessarily raise problems, even if the same neutral party continues as an arbitrator (or as one of the arbitrators) after an unsuccessful mediation. The benefit is that the neutral party, now the arbitrator, is already acquainted with the case.

There may be no reason, however, to be too confident. Process material, in particular, collected in a facilitative mediation process, may not provide proper grounds for arbitration, in which the process requires more discipline regarding, *inter alia*, the claim and its alteration, or preclusion and also the burden of proof. On the other hand, many European countries, without burdensome discovery systems, could cope with this problem quite well. Certainly, fewer problems will surface when mediations succeed. Then the same neutral party, as an arbitrator, can confirm the settlement as an arbitral award (Med-MiniArb) for enforceability, according to the New York Convention of 1957. However, in liquidation proceedings, enforceability is usually not important, as the insolvency practitioner distributes the assets to the creditors. In restructuring proceedings, however, the situation is different.

The collectivity of insolvency proceedings means that in the insolvency context, ADR processes are multi-party proceedings or else, the outcome of two-party ADR has to be accepted by all affected parties. Mediation in a multi-party context is still a challenge. Currently, the evolution of procedural law is an interesting phenomenon. There is a transition from formal procedural thinking to discussions on the functions of the processes and, after that, the criteria for a fair trial came into the spotlight. What next, however?

ADR combinations for improving the processes express, arguably, procedural-design thinking with sustainability as a meta-theory. To put it simply, sustainability means saving something for the future and includes aspects of social, human, economic and environmental sustainability. Insolvency proceedings can be sustainable, resource-wise, in two senses.

The first is that the outcome of insolvency proceedings should be designed to save economic and human resources, i.e. jobs, business relationships, property values, non-material achievements and marketing efforts. That is why the preferred choice is fresh financing in pre-insolvency or formal restructuring proceedings. Nevertheless, in liquidation proceedings, one also encounters the reality that many existing resources can be saved by selling the businesses as a going concern and, in the case of a group of companies, by maintaining synergy-producing structures.

The second is that the procedure itself should utilise resources wisely, including efficient dispute-resolution mechanisms. In disputes between natural persons, fair-trial requirements are crucial, whereas, in commercial disputes, there is usually no such need to protect the parties. For example, in mediation based on expert evaluations, the parties might agree the same neutral party can continue as an arbitrator without disqualification.

When proceedings are responsive to sustainability, the focus is not on the past but on the future. For example, instead of harsh cross-class cram-down voting, mediation could lead to an amicable outcome. That would be advisable, especially when some of the parties might have common future business interests. The combinations of ADR processes in an insolvency context (for example, Ins-Med-MiniArb), instead of insolvency connected litigation (Ins-Lit), could perhaps help insolvency proceedings reaching this double sustainability. As long as costs remain reasonable, no major problems should occur with systems that include different neutral parties at each stage.

In the future, however, insolvency practitioners could possibly, according to service-design thinking (SDT), offer their services on a broader basis and, if the parties so wish, act as neutral parties in insolvency-linked ADR regarding dissent in collective insolvency proceedings and ancillary or non-ancillary insolvency-linked disputes. In the best-case scenario, time and costs will be saved. In fact, mediation will let the parties retain control over outcomes and preserve prospects for future business relationships. ■

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