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Confidentiality Fundamentals: A Continuing Discussion

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A previous article in the *ABI Journal*[1] discussed the fundamental importance of confidentiality in the mediation process — and the challenges advocates and party participants face in ensuring that confidentiality remains intact and protected given the absence of any national rule. The previous article examined at length two Delaware cases (both arising prior to important February 2022 amendments to Delaware Local Rule 9019-5) to describe how courts had grappled with various challenges to confidentiality. The article strongly encouraged parties (and mediators) to seek comprehensive mediation orders incorporating protective language prior to the commencement of any mediation session to ensure the broadest possible application and shore up expectations.

Since that article, the importance of confidentiality in mediation has not subsided, nor have the efforts to curb confidentiality diminished. The Third Circuit recently issued an opinion that upheld lower court decisions preventing the disclosure of mediation communications. In so doing, the Third Circuit had the opportunity to enforce 2022 Delaware Local Rule 9019-5, which was drafted and specifically designed to ensure confidentiality.

Although *In re Zohar III Corp.*,[2] was issued on a "not for publication" basis, it is well worth exploring and understanding the underpinnings of that decision, which highlighted the fact that the concept of confidentiality remains fundamental to the mediation process. In addition to that decision, another recent decision arising out of the Southern District of Texas in *In re Barretts Minerals Inc.*[3] also upheld the confidentiality of mediation proceedings and shielded them from potential discovery efforts contemplated by one of the participating parties.

In re Zohar III Corp.

Patriarch Partners LLC, a private investment firm founded in 2000 by Lynn Tilton, created a series of collateralized investment funds called the "Zohar Funds." Its assets were comprised mostly of loans to, and equity positions in, distressed businesses (referred to as the "portfolio companies"). Once a portfolio company had been sold, the net proceeds would "waterfall down" to pay principal and interest payments on notes held by investors in the Zohar Funds.[4]

However, due to financial difficulties resulting from extensive litigation, the Zohar Funds defaulted on their payments to the noteholders and thus filed for chapter 11 protection. After creditors and other parties-in-interest filed several motions in the case, the bankruptcy court assigned the case to mediation, which resulted in the execution of a settlement agreement between the parties.[5] Relevant to the Third Circuit's decision, the settlement agreement (1) replaced Tilton as the Zohar Funds' controller with an independent director; (2) implemented a stay of current and future litigation to allow the Zohar Funds to convert its assets to cash; (3) outlined a process to sell fund assets; and (4) included rules and procedures for addressing any disputes arising from breaches of the settlement agreement, including the ability to seek an order from the bankruptcy court to resolve certain disputes.

Following subsequent failed negotiations between the parties, various Patriarch stakeholders (the "appellants") filed an administrative-expense claim alleging that the Zohar Funds failed to abide by their obligations under the settlement agreement to negotiate in good faith.[6] To support their administrative-expense claim, the appellants sought to introduce evidence — specifically, proposals made by the parties to the settlement agreement during the mediation period, certain terms of those proposals and what the parties did in response to these proposals.

Delaware Local Rule 9019-5(d)(i) provides that "the participants in any mediation are prohibited from divulging, outside of the mediation, any oral or written information disclosed by the parties or by witnesses in the course of the mediation." Nonetheless, the appellants sought leave to introduce the foregoing information from the mediation into evidence, which request the bankruptcy court denied and ordered the Zohar Funds to file a motion to strike relevant portions of its pleadings.[7] On appeal, the appellants argued that

1 Leslie A. Berkoff & John G. Loughnane, "Limitations on Confidentiality," XLI *ABI Journal* 9, 26-27, 47, September 2022, *available at* abi.org/abi-journal/limitations-on-confidentiality (unless otherwise specified, all links in this article were last visited on Nov. 21, 2024).
2 *In re Zohar III Corp.*, 2024 U.S. App. LEXIS 10790.
3 Case No. 23-90794.
4 *In re Zohar III Corp.*, 2024 U.S. App. LEXIS 10790.
5 *Id.* at *3.
6 *Id.* at *5.
7 *Id.*

both the bankruptcy and district courts erred because the Zohar Funds (1) had waived or forfeited the protections of Local Rule 9019-5(d), and (2) the interests of justice required disclosure.

As to the first issue regarding forfeiture (waiver), the Third Circuit held that there was no forfeiture of the Local Rule's protections because "nothing in the Settlement Agreement *explicitly* evinces the parties' desire to forgo the confidentiality protections of the local rule."[8] The Third Circuit reasoned that if the parties wanted to litigate matters discussed at mediation, they could simply ask the bankruptcy court to lift the mediation confidentiality rule (namely, a "modification") by way of separate application — but the parties had not done so in the instant case.[9]

Thus, since the parties had not explicitly waived the protections of the Local Rule, and confidentiality was otherwise not impliedly waived, the Third Circuit affirmed the district court's decision to reject that argument. The Third Circuit similarly rejected the argument that the Zohar Funds' cross-examination of a bank representative in respect of certain matters had constituted a waiver, adding that any information obtained as part of this process was part of a different bankruptcy proceeding (and an unrelated matter).[10]

The appellants secondly argued that the Local Rules' "interest of justice" modification exception required that they be permitted to rely on the evidence from the mediation.[11] The Third Circuit first reasoned that in utilizing methods adopted by other sister courts' decisions, which conduct balancing tests to render decisions on this issue, there had to be a balance of the need for the information against the protection of the communications.[12] Thus the Third Circuit concluded that here, the bankruptcy court had similarly balanced those interests in considering the integrity of the mediation process, the expectations of all parties (which included other parties), and the potential for frivolous litigation resulting from unhappy mediation participants whose offers were not accepted.[13]

Moreover, the district court had built on this balancing construct by applying the factors considered by other circuit courts of appeals, such as the parties' need for confidential materials and unfairness from a lack of discovery. In so doing, the district court correctly held that there was no unfairness, as all parties knew of the confidential nature of mediation. Lastly, the circuit held that there exists a significant public interest in maintaining and preserving the confidentiality of mediation discussions. Based on all of the foregoing, the Third Circuit determined that had been no abuse of discretion in that decision by the lower court.[14]

8 *Id.* at *8 (emphasis added).
9 *See* Del. Bankr. L. R. 1001-1(c) (2019) ("Modification. The application of these Local Rules in any case or proceeding may be modified by the Court in the interest of justice.").
10 *Id.* at *9.
11 *Id.* at *13.
12 *See In re Anonymous*, 283 F.3d 627, 636-37 (4th Cir. 2002) (holding that "it is necessary to examine the relevant interests protected by nondisclosure, [the] public interest in protecting the confidentiality of the settlement process and the countervailing interests, such as the right to every person's evidence"); *see also In re Teligent Inc.*, 640 F.3d 53, 58 (2d Cir. 2011) (stating that party seeking disclosure must "demonstrate (1) a special need for the confidential material, (2) resulting unfairness from a lack of discovery, and (3) that the need for the evidence outweighs the interest in maintaining confidentiality").
13 *In re Zohar III Corp.*, 2024 U.S. App. LEXIS 10790, *14.
14 *Id.* at *15.

In re Barretts Minerals Inc.

In the chapter 11 case of *Barretts Minerals Inc.*, the debtor's former owner sought the right to conduct potential discovery of various communications to be exchanged in mediation sessions among the mediator, the debtor, the official committee and a future claimants' representative.[15] The debtor filed for bankruptcy in October 2023 in response to significant personal-injury litigation commenced by individuals claiming injuries from exposure to materials sold by the debtor.

Three decades before the chapter 11 filing, the former owner (Pfizer) had entered into an agreement to indemnify the debtor for certain claims as part of Pfizer's spin-off of the debtor's parent. Disputes over Pfizer's indemnification obligations under that agreement apparently caused the debtor to incur direct liability to claimants, contributing to the need for bankruptcy relief.

The bankruptcy court appointed a mediator in January 2024 in an effort to resolve issues relating to the claimed injuries and the formulation of a restructuring plan. Based on some recent decisions, Pfizer filed a "Motion to Amend the Joint Stipulation and Agreed Order Appointing Mediator and Governing Mediation Procedures" (Doc. 542) seeking to add the following language to the order appointing the mediator:

> Nothing herein shall alter, abridge or expand the rights or obligations of any Mediation Parties or non-Mediation Parties with respect to the discoverability or admissibility of communications, information, or documents related to or exchanged during the Mediation, including, without limitation, with respect to documents relating in any way to any proposed trust distribution procedures or matters related thereto or to plan confirmation, or to non-debtor Pfizer Inc.'s or non-debtor Minerals Technologies Inc.'s rights or obligations under the Reorganization Agreement between Pfizer Inc. and Minerals Technologies Inc., dated as of September 28, 1992, as amended.

In support of its motion, Pfizer cited limited relief granted in proceedings occurring in *In re Boy Scouts of America and Delaware BSA LLC* on a motion for a protective order sought by the debtors in connection with ongoing mediation proceedings and related requests for discovery — an issue discussed at length in the September 2022 article.[16] Specifically, Pfizer included in its motion a transcript of a hearing held on Oct. 25, 2021, in the *Boy Scouts* case.[17]

In the *Barrett* case, both the debtor and future claimants' representative filed objections to Pfizer's motion opposing Pfizer's request to include additional language to the mediation order allowing for the prospect of discovery of mediation communications. At a hearing held on March 4, 2024, the bankruptcy court rejected the motion in clear terms:

> It is the antithesis of what should occur in the mediation. We're not going to have people worried that

15 Ben Zigterman, "Barretts' Mediation Docs Not Open to Pfizer, Judge Says," *Law360* (March 4, 2024), *available at* law360.com/articles/1809503/barretts-mediation-docs-not-open-to-pfizer-judge-says (subscription required to view article).
16 "Limitations on Confidentiality," *supra* n.1.
17 *Id.*, as detailed in n.5 of that article.

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> every conversation they have in the mediation is then going to be subject to examination. I'm not going to tie the mediator's hands as to what he can say to people, which in effect I would do if I allowed the mediation to open up.[18]

In coming to the above conclusion, the judge first required debtor's counsel to acknowledge the obligation under the mediation order not to disclose information from the mediation for any purpose, including attempting to establish good faith for plan confirmation.

18 Docket 680.

Conclusion

The Third Circuit Court's decision in *In re Zohar* and the Southern District of Texas's order in *In re Barretts Minerals Inc*. serve as reminders that confidentiality is integral to mediation. The 2022 article discussed instances where certain limitations on confidentiality occurred for reasons specific to those cases. The results in both *Zohar* and *Barretts* serve as good reminders of judicial acknowledgment of confidential fundamentals. Participants and mediators should continue to take appropriate steps to invoke all applicable protections at the outset of any mediation session. abi