United States Senate Subcommittee on Federal Courts, Oversight, Agency Action, and Federal Rights
Committee on the Judiciary

Supplement to Hearing on "Abusing Chapter 11: Corporate Efforts to Side-Step Accountability Through Bankruptcy"

Hon. Judith K. Fitzgerald (Ret.)'s Responses to Written Questions of Senator Thom Tillis

1. *Tell me about how the system works for people who might discover their injury a few years down the road. Does the current Chapter 11 process allow for injured people to access compensation right away as well as in the future if it takes them a while to discover their injury? Or are they out of luck if they don't get in to file a claim right away?*

   People who have been exposed to a product or circumstance that will eventually result in a recognizable injury but who do not realize they have been injured at the time a bankruptcy is filed are generally referred to as "future demand holders," "future claimants," or "futures." In Bankruptcy Code section 524(g), Congress has enabled futures to be represented by a future claimants' representative, referred to as an "FCR," who participates in the bankruptcy case on their behalf. 11 U.S.C. § 524(g). Although there is no other provision in Chapter 11 that provides for the appointment of an FCR, the practice used in section 524(g) has been utilized in other mass tort cases and sexual abuse cases that do not have the very large numbers of claims typical to toxic substance mass tort cases. In these cases, as part of the plan confirmation process, a trust is formed and the FCR continues to represent the interest of the futures. The trust lasts until the claims are paid, which can be decades in the case of toxic torts, to give the futures the opportunity to submit their claims to the trust once the claim is known and actionable (i.e., the claimant now has a disease). Then the same review process that occurs for present claims is used for the futures and, when a future claim is determined to comply with the trust distribution procedures, payment is issued.

   It is not possible to answer this question succinctly in cases where a debtor pays claims through a confirmed plan but without the trust mechanism described above. The answer is much more complex and depends on the facts of each case. Factors such as whether the claim arose prepetition or post-petition, the type of notice provided to file claims in the bankruptcy case, the notice provided regarding debtor's discharge, how the plan is structured regarding such claims, and many other matters all must be considered in making a determination of whether the claim can be brought against a reorganized debtor. Generally, if the claim has not been discharged, then the claimant can pursue the reorganized debtor.

2. *Do you have a sense of how the turnaround time for compensation under one of these funds compares with the turnaround time in a personal injury lawsuit through the courts? I mean, it seems like a compensation fund might be quicker? And isn't a lawsuit kind of a gamble compared to a fund that is already set aside?*

As a litigator and retired bankruptcy judge, my personal opinion is that a lawsuit is always a kind of gamble because one never can be certain how a jury will rule and what factors will sway that jury for or against a claimant. Nonetheless, it is difficult to compare what happens in tort litigation with what happens when a claim is submitted to a trust. The claimant must satisfy the requirement to prove entitlement to compensation and the elements that must be shown differ with each trust. Each trust is established to address a particular type of liability that the particular debtor faces, and how a claimant must prove that liability necessarily depends on the facts and circumstances of each case. Hypothetically, for example, a trust to address asbestos personal injury claims will require different proof than a trust to address property damages. How quickly a trust claim is processed depends on many factors including, *inter alia*, how quickly the claimant produces all the evidence required by the trust and whether the claimant has requested the trust to defer processing the claim. Once all the required information is submitted, the trust processes the claim and issues payment.

A future claimant who discovers he or she was injured by a company faces significant uncertainty and risk about when, whether and how much he or she will obtain as a judgment and be able to collect in the tort system, assuming that the company remains in existence. In the tort system the claimant must prove liability and then damages. That claimant faces substantially less risk in recovering from a trust, as the liability is admitted and the amount of the distribution is fixed and known by virtue of the requirements of section 524(g) and the timing is fixed by the terms of the trust distribution procedures.

a. *The plaintiffs' bar claims delay, but isn't that entity the sole source of delay in all of the divisional merger cases, to the point, in most cases, of even refusing to start a negotiation?*

   I do not have information sufficient to say that the sole source of delay in all divisional merger cases is the plaintiffs' bar. In my experience, all constituent parties negotiate to try to reach a consensual plan, even though the negotiation is not always successful in that regard. However, the divisional merger strategy changes the dynamics of chapter 11.

   The Texas Two-Step enables a solvent entity to avoid the balances Congress established in chapter 11 by permitting use of a state law to split the liabilities and assets into different entities and then filing bankruptcy only for "BadCo" with its overwhelming liabilities, no business or employees, and few, if any, assets; removing the valuable assets from the purview of the bankruptcy court by keeping "GoodCo" out of bankruptcy; enabling "GoodCo" to use its assets free of any oversight of the bankruptcy court and without any assurance that the assets are preserved for the benefit of the creditors; and, so far, successfully stopping all actions and claims from proceeding against "GoodCo" and related entities even though they have not invoked the provisions of the Bankruptcy Code. This structure is entirely different from the situation that Congress envisioned in enacting chapter 11, in which a debtor puts all of

its assets and liabilities before the court, subject to scrutiny by the United States Trustee and the public, and negotiates a resolution with its creditors. The incentive to exit bankruptcy as quickly as is feasible has no import in this process. "GoodCo" can go about its business, free of lawsuits and claims that it otherwise would have faced before the divisional merger. The longer "GoodCo" can remain in that position, the less incentive there is to devote what have become assets belonging only to "GoodCo's to assist "BadCo" (which has no business to reorganize in any event) from emerging from bankruptcy.

b. *In one current divisional merger case, the debtors and the future claimants representative representing 80+% of asbestos claims have negotiated a deal for over half a billion dollars for claimants. Yet even in that case, the plaintiffs' bar refuses even to engage and continues to delay payment to claimants. Don't examples like these refute the various statements that the debtor is causing delay or trying to avoid providing compensation?*

I do not know what case is referenced. In my experience the FCR generally does not represent 80% of asbestos claims as the number of *current* mass tort claims far exceeds estimates of how many future claims are likely to be submitted over time. And of course, they are "future" claims because no one knows for certain how many there are and how many will be submitted.

3. *Can you explain how the compensation funds come together? What's the process and what kind of oversight do the funds have? And who has a seat at the table in the negotiation when these funds are put together? Is it just the current creditors or do people who might make a future claim have any representation to protect their rights in these discussion[s]?*

In the mass tort context, the trust funds are put together from a combination of contributions, generally including the debtor, insurance companies that settle their policies with the debtor, and third parties who want to receive an injunction against lawsuits that could be or have been brought against them and a release of liability for claims that could be or have been brought against the third party. When all creditors and parties in interest agree, consensual third-party releases are often issued in favor of those third parties.

Typically in a mass tort context, a plan that will provide for a trust is negotiated for by the debtor with the tort claim creditors, the FCR (who is included to protect the interests of future claimants), third-parties who want to contribute to the fund and insurers who want to settle their policies. Insurers who do not want to settle their policies generally are not included in the bargaining, once the decision has been made that they will not settle.

Trusts are created under and governed by applicable state law. In some cases, the trustees report to a board which oversees the trustees. In the mass tort context, one or more trustees who have fiduciary duties to the trust beneficiaries are designated to administer the trust; the trustees hire, direct and supervise the claims administrators and make distributions on valid claims. Trustees are generally required to consult with the other fiduciaries, *i.e.*, the

FCR and members of the Trust Advisory Committee ("TAC"), for certain matters identified in a trust agreement, such as making changes to the trust or to the payment percentages paid out by the trust.

Trust agreements typically include requirements to undergo audits and testing procedures and to file annual reports with the court. Audits are conducted of the medical and exposure evidence submitted by selected claimants and often contain penalties when the audit reveals improper or fraudulent conduct. Audits also examine the trust's operations regarding the number of claims submitted, reviewed, and paid in a set time period. Audits of the trust's finances are used to insure that the trust is in a position to pay future claimants to the same extent that payments have already been made to others.

a. *Given that the lion share of the money spent in tort cases goes to lawyers and not asbestos claimants, and that a large percentage of those claims are ultimately dismissed after proving to be frivolous or fraudulent, wouldn't that money better be redirected to a trust system for all legitimate current and future claimants?*

I am unaware of a prevalent practice of lawyers taking the lion's share of money in asbestos cases. I am aware that state bar associations regulate contingent fees and many have statutes to address frivolous lawsuits. In federal court, lawyers must comply with Federal Rule of Civil Procedure 11 (or its analogue Federal Rule of Bankruptcy Procedure 9011), which authorizes the imposition of sanctions for frivolous actions. Likewise the Rules of Professional Conduct proscribe an attorney from charging an illegal or clearly excessive fee. *See, e.g.,* ABA Model Rules of Professional Conduct Rule 1.5. Fees.

The purpose of post-confirmation trusts is to provide compensation to legitimate current and future claimants and the trusts have mechanisms in place to analyze claims. Claims that are determined not to meet the criteria for payment are not paid.

4. *A court recently found rampant fraud perpetrated by plaintiff lawyers in the tort system on corporate defendants that necessitated a RICO lawsuit against those lawyers. Is that a concern given the calls to favor that system in these divisional merger cases?*

Assuming this question refers to actions related to the Garlock Sealing Technologies, LLC bankruptcy, my understanding is that the RICO lawsuits and counterclaims were dismissed years ago, and there was no finding of fraud. *See John Crane Inc. v. Simon Greenstone Panatier Bartlett, APC*, No. 16-CV-05918, 2017 WL 1093150, at *1 (N.D. Ill. Mar. 23, 2017), *aff'd sub nom. John Crane, Inc. v. Shein L. Ctr., Ltd*., 891 F.3d 692 (7th Cir. 2018); *Simon Greenstone Panatier Bartlett PC v. John Crane, Inc*., No. 216CV01179CBMAGR, 2016 WL 4769749, at *6 (C.D. Cal. Aug. 26, 2016), *appeal dism'd sub nom Garlock Sealing Technologies v. Simon Greenstone Panatier Bartlett,* APC, No. 15-2178 (4th Cir. Sept. 7, 2017).

5. *I have introduced, alongside Senators Grassley and Cornyn, legislation designed to promote transparency and accountability in asbestos bankruptcies and trusts funds created to compensate asbestos victims. The PROTECT Asbestos Victims Act would require the appointment of independent, non-conflicted fiduciaries and allow the Department of Justice to audit bankruptcy trust funds. Do you believe that Congress, if it considers any modification to bankruptcy courts' consideration of divisive mergers and non-debtor releases, should also consider reforms that would promote equitable distribution of funds and deter waste, fraud, and abuse that may limit victims' access to compensation?*

I firmly believe in protecting the integrity and goals of the bankruptcy system, which helps so very many people and companies resolve their financial problems and provides a path forward that otherwise would not be available. Using the Department of Justice to audit post-confirmation trusts, however, may pose constitutional issues and questions regarding the appropriate role of the United States Trustee when there is no bankruptcy pending and the trusts are governed by applicable state law.