

Questions from Senator Tillis for Paul Zumbro

Q.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?

A.1. Section 524(g) was added to the Bankruptcy Code to allow both present and future claimants to recover. The first Johns-Manville trust failed because funds were not preserved for future claims, so claimants rushed to submit their claims and depleted the trust within a few years after it was created. Section 524(g) now requires the court to ensure that the trust "provide[s] reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner."

All section 524(g) trusts have processes that allows claimants with current injuries as well as those who discover injuries in the future to submit claims to the trust and receive compensation. These processes include periodic adjustments of the amounts to be disbursed over time and require that future claimants' representatives ("FCRs"), who have fiduciary duties to protect the interests of future claimants, consent to significant changes in trust administration and fund distribution. Thus, individuals who are not yet aware of their injuries are not out of luck, and their claims should be treated in substantially the same manner as earlier claims.

Q.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?

A.2. Yes, compensation through the section 524(g) trust is designed to be quicker. The trust distribution system is supposed to be predominantly an expedited system that avoids the drawn out trial and appeals processes of normal litigation. Generally, a trust has an expedited review procedure and an individual review procedure. The expedited review procedure allows for faster, fixed payments based on predetermined criteria regarding the extent of one's injury and level of exposure to the debtor's asbestos-containing products. Trusts also give claimants the opportunity to pursue an individual review procedure, which requires additional documentation of evidence of injuries and asbestos exposure (similar to the discovery process) and can take as long as resolution through litigation would take. Thus, the claimant decides whether to accept general treatment based on preestablished criteria for quicker compensation or seek individualized treatment through a longer process. When comparing the time to compensation between litigation of a claim and the processing of a claim by a trust, generally speaking the compensation fund should be quicker, but it depends on the individual claimant's choices and circumstances.

Further, resolving asbestos claims through litigation is a gamble in that two similarly situated claimants could receive two very different outcomes in litigation, which courts and commentators have described as a "lottery". One claimant may receive a large verdict, while the other claimant, perhaps due to poor representation or an unpersuaded jury, may receive nothing.

Section 524(g) trusts avoid these disparate outcomes, as all similarly situated claimants, present and future, must be compensated in substantially the same manner.

Q.2.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?

A.2.a. In all of the divisional merger cases to date, there has been a lot of time spent on legal skirmishes over whether divisional merger bankruptcies are appropriate uses of the bankruptcy system and whether filings have been made in good faith. It could be argued that this has been to the detriment of claimants seeking as much compensation as soon as possible. Perhaps now that Judge Kaplan in the LTL Management case has found the divisional merger bankruptcy was not filed in bad faith, all parties in divisional merger cases will spend more time negotiating the terms of trusts and preparing for estimation hearings rather than arguing motions and objections to the bankruptcy filing. The sooner the section 524(g) trusts are approved, the sooner injured claimants on the whole will receive fair and equitable compensation.

Q.2.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?

A.2.b. I believe you are referring to the Aldrich Pump case, in which debtors Aldrich Pump and Murray Boiler have estimated that future claims will make up over 80% of the total asbestos claims and the FCR has supported the debtors' proposed plan of reorganization. Certainly, motions by asbestos claimants committees asking the court to undo the divisional merger through substantive consolidation, as in the Aldrich Pump case, or alleging the divisional merger bankruptcy filing was made in bad faith, as mentioned above, are delaying the formation of the 524(g) trusts and compensation to claimants. Contrary to what asbestos claimants committees argue, debtors likely have little incentive to delay; while there are cost savings from the stay of asbestos claim litigation, there are significant legal fees and costs involved in the bankruptcy process. Thus, it should be in the best interest of both asbestos claimants committees and debtors to reach agreements and establish trusts as soon as possible to compensate claimants quickly and to preserve debtors' resources for the payment of claims rather than legal expenses.

Regarding the statements that debtors are trying to avoid providing compensation, as I mentioned in my testimony, the best evidence that debtors are not avoiding their obligations to compensate claimants is the funding agreement in each of the divisional merger cases.

Q.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?

A.3. Much like a plan of reorganization, an asbestos claimant trust is the product of negotiations between a debtor and its creditors, with the additional involvement of the FCR. Claimants have

significant involvement in the negotiations of a section 524(g) trust, as the plan of reorganization must receive the approval of at least 75% of the claimants affected by the trust, and the FCR negotiates on behalf of future claimants to ensure equitable treatment between current and future claimants.

The trust is managed by one or more trustees, often including a retired bankruptcy judge. The trustee manages the investments of the trust in order to maximize the value of the trust and oversees disbursements from the trust. The trustee owes fiduciary duties to the claimants and manages the trust for their sole benefit.

The trust (and the trustee) must be approved by the bankruptcy court, which evaluates whether the trust meets the requirements of section 524(g) of the Bankruptcy Code, as well as the qualifications and disinterestedness of the trustee. The requirements of section 524(g) ensure, among other things, adequate funding of the trust and equality of treatment among present and future claimants. The trust is required to provide regular reports with the bankruptcy court (which are publicly filed) to ensure continued compliance with the requirements of section 524(g).

The trustee must generally obtain the consent of the trust advisory committee (which represents current claimants) and the FCR before taking any major actions, such as amending the trust distribution procedures or adjusting the percentages to be paid on claims asserted against the trust. Current claimants, the FCR and the U.S. Trustee provide continuing oversight of the trust, as they may raise objections with the bankruptcy court to the extent they believe that the administration of the trust is not in compliance with section 524(g) or orders of the court.

Q.3.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?

A.3.a. As mentioned in my testimony, the private litigation system is not able to effectively manage mass tort cases. One of the principal benefits of the trust system is that it allows limited resources to be distributed directly to claimants rather than consumed by litigation costs and attorneys' fees. As a result, the trust system generally allows for greater and faster recovery to the claimants compared to the tort system, which involves significant cost, delay and uncertainty.

Q.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?

A.4. There is always a risk of malfeasance in any court proceeding, including the potential for fraud in the tort system, which leads to inequitable results in mass tort cases. Without the protection of bankruptcy, a debtor's limited pool of assets creates a "race to the courthouse", where claimants (and their attorneys) try to receive as much compensation as possible before the

money runs out. As shown by the behavior in some cases, this can create incentives to exaggerate or even fabricate claims against the debtor.

However, the Bankruptcy Code requires that all similarly situated creditors be treated equally, and section 524(g) extends that principle so that current and future claimants are treated equally. Eliminating the “race to the courthouse” and the incentives and inequities it creates is one of the critical ways that bankruptcy is the most efficient, equitable and just way to resolve mass tort liabilities while maximizing recoveries for both present and future claimants.

Q.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?

A.5. The PROTECT Asbestos Victims Act provides that the FCR would be appointed by the U.S. Trustee, subject to approval by the court, rather than simply being appointed by the court, and that the FCR (and any professionals employed by it) must be disinterested. There has been criticism that the FCR appointed by the court is often one that is nominated by the debtor and agreed to by the current claimants. While, as a practical matter, the court must rely on the parties for nominations, there may be legitimate concern with relying on debtors and current claimants, whose interests are adverse to the future claimants, to nominate the FCR. Accordingly, having the U.S. Trustee select the FCR, subject to court approval (as provided in the PROTECT Asbestos Victims Act), may be beneficial in ensuring independence of the FCR, the protection of future claimants and the public's trust in the section 524(g) process. In addition, while most courts have found that the FCR must be disinterested, the Bankruptcy Code does not directly provide the standard for appointing an FCR (or the standard for the professionals it employs), and the provisions of the PROTECT Asbestos Victims Act would help to clarify the proper standard. Finally, the provisions of the PROTECT Victims Act that would clarify that the FCR (and the professionals it employs) may be compensated by the estate would bring certainty to potential FCRs and their professionals and potentially attract a greater pool of qualified candidates.

Beyond the provisions of the PROTECT Asbestos Victims Act that would give the U.S. Trustee greater oversight of section 524(g) trusts, I do not see a need for further legislative action to deter waste, fraud and abuse, whether in the context of divisional merger bankruptcies or non-debtor releases. Given that the primary goal of asbestos trusts and mass tort settlements (of which non-debtor releases are often a part) is to provide the greatest amount of compensation to claimants as quickly and efficiently as possible, and given the enormous difficulties that already exist in achieving a global resolution in such cases, I would be hesitant to endorse any additional requirements that may impose further delays to claimants' compensation.