Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT® JULY/AUGUST 2019

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 15 **NUMBER 5** **July/August 2019**

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Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

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MATTHEW BENDER

(2019–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc.

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

Courts Adopt More Demanding Standards for Appointing Future Claimants' Representatives in Asbestos Bankruptcy Cases

By Mark D. Plevin and Tacie H. Yoon*

Two different bankruptcy courts have adopted new, more demanding standards governing the appointment of legal representatives for future asbestos claimants in bankruptcy cases. The authors of this article analyze the decisions.

In decisions issued earlier this year, two different bankruptcy courts adopted new, more demanding standards governing the appointment of legal representatives for future asbestos claimants in asbestos bankruptcy cases.[1]

In *In re Fairbanks* and *In re Imerys Talc America*, the courts rejected previous court rulings which had held that a person was eligible for appointment as a legal representative (often described as the "future claimants' representative" or "FCR") if he or she met the "disinterestedness" standard applicable to lawyers and other professionals retained by a debtor or an official committee.

Instead, the *Fairbanks* and *Imerys* courts held that an FCR must satisfy the more demanding standard applicable to appointments of guardians *ad litem*. The courts also made other rulings that throw open the FCR appointment process to all parties in interest in a case, potentially limiting the ability of debtors and current asbestos claimants to select FCRs of their own choosing.

BACKGROUND OF SECTION 524(g) AND THE ROLE OF THE FCR

In an asbestos bankruptcy, a debtor can obtain permanent injunctive protection against not only asbestos tort claims pending at the time of confirmation but also against claims asserted post-confirmation by persons who were exposed to the debtor's asbestos pre-bankruptcy. The injunction, which is

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[1] *See In re Fairbanks Co.*, 2019 Bankr. LEXIS 1220 (Bankr. N.D. Ga. Apr. 17, 2019); Bench Ruling on Motion to Appoint James L. Patton, Jr. as the Legal Representative for Future Talc Personal Injury Claimants, [Dkt. No. 503], *In re Imerys Talc America, Inc.*, 2019 Bankr. LEXIS 1452 (Bankr. D. Del. May 8, 2019) (the "*Imerys* FCR Decision").

a supplement to the Section 524(a) discharge injunction available to reorganized debtors under confirmed Chapter 11 plans, is colloquially called a "channeling injunction" because it "channels" claims away from the debtor to a trust established under a plan of reorganization.[2] The trust assumes responsibility for paying the claims and is funded with assets of the debtor, typically including cash and proceeds of insurance settlements.

The statute that establishes this asbestos bankruptcy trust/injunction mechanism, 11 U.S.C. § 524(g), was enacted in 1994 based on the "creative solution" devised by the court in the *Johns-Manville* asbestos bankruptcy case.[3] Section 524(g) conditions the issuance of a channeling injunction on, among other things, the bankruptcy court's appointment of an FCR to advocate on behalf of future claimants, who by definition are unable to represent their own interests during the bankruptcy case.[4]

As the U.S. Court of Appeals for the Third Circuit noted 15 years ago in its seminal *Combustion Engineering* decision, "[t]here are many statutory prerequisites imposed by § 524(g)" and "[m]any of these requirements are specifically tailored to protect the due process rights of future claimants."[5] In particular, the court noted, "[i]n the resolution of future asbestos liability, under bankruptcy or otherwise, future claimants must be adequately represented throughout the process."[6]

Notably, however, the statute provides little guidance to the court charged with appointing the FCR, stating only that "the court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands" for payment of claims by the asbestos trust.[7] In particular, the statute does not say how a court should select an FCR or what

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[2] *See* 11 U.S.C. § 524(a)(2) (providing that a discharge "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor"); 11 U.S.C. § 524(g)(1)(A) ("After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section"); *Fairbanks*, ___ B.R. ___, (citing to § 524(g) and referring to "a so-called 'channeling injunction' that prevents [future claimants] from asserting their claims other than against a trust established under the plan, provided that certain requirements are met").

[3] *See* H.R. Rep. No. 103-835 at 40 (1994).

[4] 11 U.S.C. § 524(g)(4)(B)(i).

[5] *In re Combustion Engineering, Inc.*, 391 F.3d 190, 234 n.45 (3d Cir. 2004).

[6] *Id.* at 245.

[7] 11 U.S.C. § 524(g)(4)(B)(i).

standards the court should use in determining who to appoint as FCR.

In certain kinds of asbestos bankruptcies where debtors negotiate the terms of a plan of reorganization before filing for bankruptcy (so-called "pre-packaged" or "pre-negotiated" cases),[8] debtors typically retain someone (dubbed a "pseudo FCR" in one law journal article)[9] to serve an FCR-like role during the run-up to bankruptcy. Debtors typically pay such persons and their professionals for their pre-petition work on the plan negotiations, arguably undermining the pseudo FCR's independence and loyalty to future claimants. Debtors may also offer to indemnify the pseudo FCR with respect to future liability claims by persons ostensibly represented by the pseudo FCR. Then, when the bankruptcy case is filed, the debtor asks the bankruptcy court to appoint the pseudo FCR to serve as the statutory FCR under Section 524(g).

In response to objections that such persons cannot properly serve as FCRs because of their pre-petition retention and payment by prospective debtors, debtors have argued that such pre-petition retention and payment is irrelevant because the FCR nominee meets the "disinterestedness" standard applied to professionals retained by debtors and official committees. Debtors have also argued that parties other than the debtor and the official committee for current asbestos claimants lack standing to object to the debtor's proposed FCR because they do not represent the interests of future claimants. Until recently, debtors have generally prevailed in these arguments.[10]

This paradigm has recently been challenged in several new asbestos bankruptcy cases by U. S. Trustees. Stemming from concerns about fraud and abuse in the claim resolution process that were brought to light in the *Garlock* asbestos bankruptcy case,[11] U.S. Trustees have asserted recently in several cases that the

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[8] *See Combustion Engineering, Inc.*, 391 F.3d at 201 n.4; *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 224 n.5 (3d Cir. 2003) (distinguishing pre-packs from "pre-approved" or "pre-negotiated" bankruptcies and conventional bankruptcy cases); *In re NRG Energy, Inc.*, 294 B.R. 71, 82 (Bankr. D. Minn. 2003) (citing additional cases and articles on pre-packs generally).

[9] Mark D. Plevin, *et al.*, *The Future Claims Representative in Prepackaged Asbestos Bankruptcies: Conflicts of Interest, Strange Alliances, and Unfamiliar Duties for Burdened Bankruptcy Courts*, 62 N.Y.U. ANN. SURV. AM. L. 271, 291 (2006) ("FCR Article").

[10] *See, e.g.*, *In re Mid-Valley, Inc.*, 305 B.R. 425, 433–35 (Bankr. W.D. Pa. 2004). For more background information on the FCR requirement under Section 524(g) and issues that arise under that statute in pre-packaged asbestos bankruptcy cases, *see generally* FCR Article, *supra* note 9.

[11] *In re Garlock Sealing Technologies, LLC*, 504 B.R. 71, 84–86 (Bankr. W.D.N.C. 2014) (describing a "startling pattern of misrepresentation" with respect to asbestos claimants' alleged exposure to asbestos products in a sampling of claims resolved by Garlock in the tort system before filing its bankruptcy case).

selection of an FCR must be subject to greater scrutiny by bankruptcy courts in order to promote transparency and to reduce the number of fraudulent claims that are paid.

The U.S. Trustees also have expressed concerns that a "cottage industry" operates in mass tort bankruptcy cases in which the same small group of persons are chosen (by counsel for debtors and present claimants) as FCRs, giving those persons "an incentive to advocate (or to limit advocacy) so that the FCR remains in the group at the expense of future claimants."[12] The spotlight that the U.S. Trustees have shone on the FCR selection process, along with the lack of clear standards in § 524(g) for the selection of an FCR, have prompted courts to analyze anew the purpose of the FCR under § 524(g) and consider how the intent of the statute can best be fulfilled. This re-examination has led, in the *Fairbanks* and *Imerys* cases, to a rejection of previous court rulings in this area.

FAIRBANKS

In *Fairbanks*, the bankruptcy court for the Northern District of Georgia broke new ground in several areas.

In that case, the debtor nominated as FCR James L. Patton, Jr., a lawyer who had both been appointed as an FCR in asbestos bankruptcy cases and also served as counsel to other FCRs. The U.S. Trustee objected to the debtor's nomination of Mr. Patton and also nominated three other persons as FCR candidates. The bankruptcy court conducted an evidentiary hearing during which it heard testimony from all four candidates.[13]

First, the court held that any party in interest in the bankruptcy case could nominate an FCR candidate for the court's consideration. The court noted that "[w]hile historically the debtor has performed this function, nothing in the statute mandates that only the debtor may do so."[14] Even where the debtor and present asbestos claimants jointly seek to have a person who had served an FCR-like role pre-petition appointed as the statutory FCR post-petition, the selection of the FCR is not "the exclusive province of the debtor (or the present claimants)."[15] Moreover, the court held, "a debtor's or committee's choice is not

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[12] *Fairbanks*, *supra* note 1; *see also id.* (noting the U.S. Trustee's argument that "[a] future claims representative who 'rocks the boat' through aggressive advocacy may not be in the next boat").

[13] *Fairbanks*, *supra* note 1.

[14] *Id.*

[15] *Id.*

entitled to deference."[16] Rather, the court must "thoughtfully and thoroughly consider the appointment" and conduct its own "independent inquiry," such as by holding a hearing where parties may object to a proposed FCR.[17]

Second, the *Fairbanks* court broke ranks with other bankruptcy courts that had previously held that an FCR need only satisfy a "disinterestedness" standard. Instead, the court held that an FCR must meet the more demanding standards applicable to appointments of guardians ad litem. The court explained that an FCR "must perform fiduciary-like duties in his or her very special role of negotiating for individuals who will be required to participate in a claim-resolution procedure (the trust via the channeling injunction) that they had no say about."[18] The court considered what qualities future claimants would want in their representative and concluded that they "would want an individual who is objective, reasonable, and fair and who would zealously advocate for them."[19] Indeed, the court ruled, "[c]onsiderations of due process and the statutory provisions of § 524(g) require that a court examine a proposed future claimants' representative's capabilities beyond qualification and disinterestedness," because "[l]imiting a court's consideration of the appointment of an FCR to whether the candidate is 'disinterested' and facially qualified ignores the statutory purpose of the FCR, which is to provide an effective advocate for otherwise unrepresented future claimants."[20]

In determining what standard to use, the court noted that an FCR "effectively undertakes the role of a guardian ad litem," whose purpose is "to protect the rights of persons in litigation who cannot represent themselves."[21] Thus, the FCR "must advocate on behalf of unknown future claimants in the negotiation of the terms of the plan, trust, and channeling injunction and in the confirmation process to protect future claimants' rights and give them the best possible opportunity to recover."[22] This means that the FCR must "not only be disinterested and qualified; the future claimants' representative must also be capable of acting as an objective, independent, and effective advocate for the

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[16] *Id.* ("declining to rubber-stamp a debtor's candidate" causes "no unreasonable harm" to a debtor or other parties).

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

best interests of the future claimants."[23] Thus, the court "must be satisfied that, like a guardian ad litem, an FCR will provide representation that is diligent, competent, and loyal."[24]

The court rejected, however, an argument by the U.S. Trustee that a debtor's proposal of a candidate, "in and of itself," was disqualifying.[25] And while the court observed that "prepetition relationships or compensation of a candidate on the surface suggest the possibility of an actual conflict and may raise concerns," it ruled that "they do not alone demonstrate a lack of independence or partiality."[26] Whether an FCR candidate meets these standards was, the court ruled, a factual question to be determined at an evidentiary hearing.

The court then evaluated the debtor's proposed FCR candidate and the U.S. Trustee's three candidates. Following an evidentiary hearing to consider the qualifications of each candidate, all of whom the court deemed "impressive," "qualified," and able to "do the job," the court—"without giving any weight to the party who proposed" the candidates[27]—chose the debtor's candidate based largely on his experience serving as an FCR in other cases.[28]

In closing, the court said that the U.S. Trustee "is to be credited for his advocacy on these issues," particularly, because of "anecdotal evidence" that "fraud and abuse in the system does exist."[29] But, the court noted, "nothing indicates that" fraud or abuse were "present in this case."[30]

IMERYS

Several weeks later, the bankruptcy court in Delaware elected to follow the *Fairbanks* decision, rejecting previous decisions (including one by another Delaware bankruptcy judge) that had applied a "disinterestedness" standard in determining whether a person could be appointed as an FCR.

In *Imerys*, several insurers had joined the U.S. Trustee in objecting to the debtors' motion to appoint as FCR the person (as in *Fairbanks*, Mr. Patton)

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[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] *Id.* (citing *In re Garlock Sealing Technologies, LLC*, 504 B.R. 71, 84–86 (Bankr. W.D.N.C. 2014), and FCR Article).

[30] *Id.*

who had been retained by debtors to act as a pseudo FCR pre-petition. Debtors argued that the insurers lacked standing to object to the FCR motion because the insurers' interests were allegedly adverse to the interests of the future claimants. The *Imerys* court rejected the debtors' argument, finding that the insurers had standing to object to the debtors' FCR motion, because the motion raised an issue of "procedural due process that implicates the integrity of the bankruptcy court proceeding as a whole."[31] The court also noted that every party in the bankruptcy has adverse interests to the future claimants and if the court could not hear from such adverse interests, it would be unable to hear from anyone. "If I were to exclude from consideration the views of any party who had or will have an interest adverse to the legal representative, I question who I could hear from."[32]

The court next held that any party could file a motion to appoint an FCR, and that "there should be neither more nor less deference given to a candidate proposed by any movant."[33] The U.S. Trustee had proposed an ill-defined "collective proceeding" to identify potential FCR candidates, but the court rejected that proposal, concluding that it would not be appreciably different from the current process of filing a motion to appoint an FCR, seeking information about the candidates through discovery, and then holding an approval hearing.[34]

The *Imerys* court then agreed with the *Fairbanks* court that the appointment of an FCR should be subject to the standards governing appointment of a guardian ad litem, not the disinterestedness standard. The *Imerys* court observed that while "the disinterestedness standard is explicitly set forth in many other provisions of the Bankruptcy Code," it is not mentioned in Section 524(g).[35] The court found the reasoning of the *Fairbanks* decision "well-reasoned" and "persuasive."[36] The court concluded that "the legal representative is much more like a guardian ad litem that those persons in the Code subject to the disinterestedness standard" because an FCR "must be independent of the

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[31] *Id.* at 4 (citing *In re Congoleum Corp.*, 426 F.3d 675, 685 (3d Cir. 2005) (insurers had appellate standing to object to retention of special insurance counsel, which was "an issue based on procedural due process concerns that implicate the integrity of the bankruptcy court proceeding as a whole" and "will affect the resolution of issues that may directly affect the rights of insurers and fairness to asbestos claimants")).

[32] *Imerys* FCR Decision at 2.

[33] *Id.* at 5–6.

[34] *Id.* at 5.

[35] *Id.* at 7.

[36] *Id.* at 9.

debtors and other parties-in-interest in the case and be able to effectively speak for this constituency."[37] Further, an FCR's "loyalties must lie with the demand holders for whom he acts as a fiduciary, that is—the future claimants."[38]

Although the court found that the proposed FCR's pre-petition engagement by the debtors was not disqualifying by itself, the court felt that further disclosure by the FCR candidate was required before the court could determine whether the proposed FCR was sufficiently independent from other parties in the case. The court therefore ordered the proposed FCR to file a supplemental disclosure addressing points raised during his cross-examination, explaining:

(1) Statements on his law firm's website soliciting representation of current claimants;

(2) Whether his firm's representation of insurance companies in coverage litigation would constrain him from taking certain positions on behalf of future claimants; and

(3) Whether an indemnification provision in his pre-petition engagement letter with debtors could be construed to protect him from claims by future claimants that would conflict with his fiduciary duty to them.[39]

DURO DYNE

Similar issues about the selection of an FCR were raised in the *Duro Dyne* bankruptcy case in New Jersey. There, the bankruptcy judge in an October, 2018, ruling applied the "disinterestedness" standard later rejected by the *Fairbanks* and *Imerys* courts.[40] The U.S. Trustee, however, has appealed the bankruptcy court's ruling to the New Jersey district court; the appeal is fully briefed and, indeed, the U.S. Trustee has filed post-briefing letters with the

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[37] *Id.* at 10.

[38] *Id.*

[39] *Id.* at 12–13.

[40] *See* Order Appointing A Legal Representative For Future Asbestos Personal Injury Claimants Effective As Of The Petition Date, [Dkt. No. 191], *In re Duro Dyne Nat'l Corp.*, No. 18-27963 MBK (Bankr. D.N.J. Oct. 17, 2018); *See also* Transcript of Hearing at 79:15-80:2, *In re Duro Dyne Nat'l Corp.*, No. 18-27963 MBK (Bankr. D.N.J. Oct. 1, 2018) (applying the disinterestedness standard applies to selection of an FCR and allowing discovery regarding proposed FCR's disinterestedness); Transcript of Hearing at 17:22–24, *In re Duro Dyne Nat'l Corp.*, No. 18-27963 MBK (Bankr. D.N.J. Oct. 16, 2018) ("the standard applicable to appointment of an FCR is whether he is disinterested under 11 U.S.C. 101(14).").

district court bringing the *Fairbanks* and *Imerys* rulings to that court's attention.[41]

CONCLUSION

Time will tell whether the recent *Fairbanks* and *Imerys* decisions will be widely adopted by other courts or, instead, if courts will reject those decisions and follow earlier case law. At a minimum, it is noteworthy that decades after § 524(g) was enacted, bankruptcy courts have been persuaded to take a closer look at the process and requirements for appointment of FCRs, in an effort to ensure that future claimants receive sufficient protection of their rights to satisfy due process and uphold the integrity of the bankruptcy process.

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[41] *See* Letters from Acting United States Trustee, [Dkt. Nos. 18 and 22], *Vara v. Duro Dyne Nat'l Corp. (In re Duro Dyne Nat'l Corp.)*, No. 3:18-cv-15563-MAS (D.N.J. Apr. 22, 2019, and May 21, 2019).