

CONSTITUENCIES AND OBJECTIVES IN MASS TORT CLAIM CASES

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As contemplated by Congress, Chapter 11 proceedings involve a competition among several groups who may define success and victory in a variety of ways. The debtor's success may be found in a rehabilitated business or a sale to a friendly suitor. Creditors find value in maximizing distributions and, perhaps, preserving a customer for a continuing relationship. Shareholders seek to retain a portion of their investment. Throughout the reorganization process, these groups, represented by the debtor-in-possession, creditor groups, and committees, strive to reach a conclusion that, if not acceptable to all, produces a confirmable plan.

The complexities and challenges of this objective are magnified in those Chapter 11 cases involving massive tort claims. Bankruptcy courts have dealt with claims from a myriad of product liability cases, most notably, asbestos, Dalcon Shield, and silicone gel breast implants. More recently, five bankruptcy courts have been the venue for resolution of claims arising from the sexual abuse scandal within the Catholic Church. These cases involve a unique type of creditor, the tort claimant, and the involvement of other non debtor parties who seek finality in resolving these tort claims. These materials will review the unique constituencies in the mass tort cases and discuss some of the objectives that appear in these cases.

Unique parties in mass tort cases.

In mass tort cases, tort claimants are not necessarily a uniform, monolithic class of creditors. In most cases, tort claimants fall into at least three categories; individuals who have initiated litigation, individuals who have asserted claims but have not yet instituted litigation, and individuals who are unaware of their potential claims at the time of the bankruptcy filing. In certain cases, the types of tort claims can differ significantly. For example, Professor Francis E. McGovern noted that tort claimants in the traditional asbestos case are separated into group based on the nature of the damages (property damage or personal injury), types of personal injury claims, and future claims. See Francis E. McGovern, *Asbestos Legislation II: Section 524(g) without Bankruptcy*, 31 Pepp. L. Rev. 233, 236 (2003).

Future claimants present challenges for the court and the parties in seeking a reorganization which effectively resolves all claims which arose prior to the filing of the bankruptcy proceeding. Critical to this resolution process is the appointment of a representative for future claimants. The importance of this representative has been codified in the Bankruptcy Code with respect to asbestos cases in section 524(g)(4)(B). The significance of the future claims representative in asbestos cases has created important discussion and criticism. *See, e.g.,* Mark Plevin, Leslie A. Epley, and Clifton S. Elgerton, *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. Sur. Am. L. 271 (2006); Lester Brickman, *Ethical Issues in Asbestos Litigation*, 33 Hofstra L. Rev. 833 (2005). Commentators

argue that the future claims representative must be truly independent of any other party in an asbestos case and encourage bankruptcy courts to carefully scrutinize the future claims representative recommended by the debtor. One commentator maintains that section 524(g) is unconstitutional because the provisions of section 524(g) fail to provide due process to future claimants. See *Note Demanding Due Process: The Constitutionality of the §524 Channeling Injunction and Trust Mechanisms That Effectively Discharge Asbestos Claims in Chapter 11 Reorganizations*, 80 Notre Dame L. Rev. 1187 (2005).

The future claims representative is a critical player in other mass tort cases as well. For example, the debtor in *In re The Roman Catholic Church of the Diocese of Tucson* (Case #4-04-04721 BK. Az) included provisions in its reorganization plan for the appointment of a future claims representative and a guardian ad litem for any minors who are victims of sexual abuse. The plan provided that the debtor would provide the bankruptcy court with three proposals and the court would select one.

Another significant constituency in these cases are insurers and third parties involved in the tort litigation. These parties present complicated and sometimes conflicting issues noted by Professor McGovern:

Insurers are potentially among the most complicated groups. These may be both settled and unsettled policies, provisions with and without indemnity, and some policies that are liquidated while others have coverage currently in place. Insurers who have made payments that have benefited the debtor may have potential subrogation claims against the debtor. Co-defendants may also seek contribution or indemnity for payments they have made.

McGovern, 31 Pepp. L. Rev. at 235.

In the Catholic Church cases, the parishes within the diocese present a unique issue in resolution of the bankruptcy case because the parishes may have multiple positions. As a general rule, parishes within a diocese of the Roman Catholic Church are unincorporated associations led by a pastor. Legal title to parish property is held by the bishop as a corporation sole for the benefit of the parish. Allegations of abuse may be asserted against the parish. Lastly, the parish may be owed payments from the diocese. As a result, the parishes may be defending challenges from creditors seeking an order from the bankruptcy court that parish property is property of the estate in the diocese bankruptcy proceeding; protecting against claims from victims; and asserting claims against the diocese.

A final major player in the bankruptcy proceeding involving mass tort claims can be the neutral or mediator. Professor McGovern noted that he has served as the court appointed neutral in *Manville*, *UNR*, *Amatex*, *National Gypsum*, *Celotex*, *Federal-Mogul*, *Owens Corning*, and *Kaiser* bankruptcies as has served as a mediator in other asbestos cases. See *McGovern*, 31 Pepp. L. Rev. 233 fn. 1A. The United States Court of Appeals for the Sixth Circuit acknowledged the role of the mediator in producing a plan in *Dow Corning*. See *In re Dow Corning Corp.*, 280 F. 3d 648, 654 (6th Cir. 2002).

Objectives of these unique constituencies.

The tort claimants seek recovery for the injuries they sustained as a result of the debtor's product, action or inaction. While the objective is apparent, achieving it is complicated by the parties present and the objective of a major source of the funds for settlement of these claims. The tort claimants will need to create some level of certainty that the funds established by the reorganization plan will provide them with reasonable compensation. One example of the challenges facing tort claimants is found in *Dow Corning*:

The Judicial Panel on Multidistrict Litigation consolidated the breast implant litigation for administration of a pre-trial matters. See *In re Silicone Gel Breast Implants Prods. Liab. Litig.*, 793 F. Supp. 1098 (1992). The consolidated litigation led to a proposed \$4.225 billion global settlement, which the multidistrict litigation court approved in 1994. See *Lindsey v. Dow Corning Corp.*, (In re Silicone Gel Breast Implant Prods. Liab. Litig.), No CV92-P-10000-S, CW.A. No CU94-P-11558-S, 1994 WL578353, at 1 (N.D. Ala. Sept. 1, 1994). However, hundreds of thousands more women than anticipated filed claims with the global settlement fund and the settlement collapsed in 1995.

In re Dow Corning Corp. 280 F.3d at 654.

The insurers and other third parties, along with the debtor, seek finality with any settlement. Each seeks to obtain a broad channeling injunction which precludes further claims arising out of or related to the product or conduct of the debtor. The *Johns Manville* bankruptcy proceeding developed the channeling injunction in its plan. Since the Johns Manville filing in 1982, several more asbestos related businesses sought relief. Congress enacted section 524(g) and (h) in an effort to bring certainty to the channeling injunction process with respect to asbestos cases. See 140 *Cong. Rec. H. 10,765* (October 4, 1994).

The importance of finality through the channeling injunction is present in mass tort cases other than asbestos related matters. Courts which have ruled favorably upon the issue of channeling injunctions based upon section 1123(b)(6) as an appropriate provision of a reorganization plan. For example, the Sixth Circuit articulated the basis in which the bankruptcy court may issue an injunction which protects parties other than the debtor upon confirmation of a plan of reorganization:

Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a non-consenting creditor's claim is only appropriate in "unusual circumstances." See *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 293 (2nd Cir. 1992); *In re A.H. Robins Co.*, 880 F.2d at 702; *MacArthur v. Johns-Manville Corp.*, 837 F.2d 89, 93-94 (2nd Cir. 1988). In determining whether there are "unusual

circumstances,” our sister circuits have considered a number of factors, which are summarized in our holding below. We held that when the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor’s claim against a non-debtor: (1) There is an entity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to the reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions. *See In re A.H. Robins*, F.2d at 701-702; *Johns-Manville*, 837 F.2d at 92-94; *In re Continental Airlines*, 203 F.3d at 214.

In re Dow Corning Corp., 280 F.3d at 658. The Sixth Circuit found that the unusual circumstances that had not been satisfied and did not confirm the plan.¹

Not all circuits agree that a bankruptcy court has the authority to issue a permanent injunction discharging non-debtors from liability as a part of a confirmed reorganization plan. Decisions of the Fifth, Ninth, and Tenth Circuits have concluded that section 524(e) of the Bankruptcy Code precludes such relief. *See Resorts International, Inc. v. Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995); *Feld v. Zale Corp.*, 62 F.3d 746 (5th Cir. 1995); *Landsing Diversified Properties II v. First National Bank & Trust Co.*, 922 F.2d 592 (10th Cir. 1990).

The diocese cases have developed mechanisms to resolve claims of victims and provide finality for the debtor and third parties. As an example, the Diocese of Tucson presented a plan which established two trusts, a settlement trust and litigation trust for resolution of claims of the victims of sexual abuse. Holders of claims had the opportunity to settle their claims or litigate. Claims which were settled would fall into one of four tiers based upon the nature of the claim. In addition, third parties such as insurers and parishes could participate and receive the benefits of a broad permanent injunction. The form of the permanent injunction for these third party participants as proposed by the debtor in its original plan was as follows:

17.3 Channeled Claims. Except as otherwise expressly provided in the Plan and in this Article 17, in consideration of: (a) the

¹ The United States Court of Appeals for the First Circuit has ruled that bankruptcy courts may issue injunctions against third party actions in extraordinary circumstances. *See In re G.S.F. Corporation*, 938 F.2d 1467 (1st Cir. 1991).

promises and obligations of the Participating Third Parties under the Plan, including the establishment and funding of the Settlement Trust and the Litigation Trust; and (b) the undertakings of the Settling Insurers pursuant to their respective settlements with the Debtor, on the Effective Date (i) all Persons who have held, hold, or may hold Tort Claims, whether known or unknown, will be forever barred from pursuing such Claims, whether such Claims are based upon tort or contract or otherwise, that they heretofore, now or hereafter possess or may possess against the Participating Third Parties and the Settling Insurers, the respective predecessors, successors, officials, shareholders, subsidiaries, divisions, affiliates, representatives, attorneys, merged or acquired companies or operations or assigns of the Settling Insurers and the Participating Third Parties, (all such parties referenced in this Section 17.3 being collectively called the “Settling Parties”), in each case based upon or in any manner arising from or related to any acts or omissions of the Diocese or any of the other Settling Parties related to any sexual misconduct or other acts committed by any clergy, employee or other Person associated with the Diocese, including, but not limited to, any volunteers and, further, including, without limitation: (a) personal injuries, including emotional distress; (b) those of any Person against whom any Claim, demand, proceeding, suit or cause of action based upon or in any manner arising from or relating to any of the matters enumerated or described herein has been or may be asserted (including, without limitation, rights of indemnity, whether contractual or otherwise, contribution Claims and subrogation Claims); (c) those for damages, including punitive damages; (d) those for attorneys’ fees and other expenses, fees or costs; (e) those for any possible economic loss or loss of consortium; (f) those for damages to reputation; and (g) those for any equitable remedy. Except as otherwise expressly provided in the Plan and the Plan Documents, the provisions of this Section 17.3 shall further operate, as between all Settling Parties, as a mutual release of all Claims. The foregoing channeling provisions are an integral part of the Plan and are essential to its implementation.

17.4 Permanent Injunction Against Prosecution of Released Claims. Except as otherwise expressly provided in the Plan, for the consideration described in Section 17.3 above or any agreement by which a Person becomes a Participating Third Party or a Settling Insurer, on the Effective Date all Persons who have held, hold, or may hold Channeled Claims or Claims against the Diocese, whether known or unknown, and their respective agents, attorneys, and all others acting for or on their behalf, shall be permanently enjoined on and after the Effective Date from: (a) commencing or continuing in any manner, any action or any other

proceeding of any kind with respect to any Claim against the Settling Parties, the Diocese, the Reorganized Debtor, the Settlement Trust, the Litigation Trust, the Trustees, and their respective predecessors, successors, officials, shareholders subsidiaries, divisions, affiliates, representatives, attorneys, merged or acquired companies or operations or assigns (collectively, the “Parties”); (b) seeking the enforcement, attachment, collection or recovery by any manner or means of any judgment, award, decree, or order against the Parties or the property of the Parties, with respect to any discharged Claim or Channeled Claim; (c) creating, perfecting or enforcing any encumbrance of any kind against the Parties or the property of the Parties with respect to any discharged Claim or Channeled Claim; (d) asserting any setoff, right of subrogation, or recoupment of any kind against any obligation due to the Parties with respect to any discharged Claim or Channeled Claim; and (e) taking any act, any manner and in any place whatsoever, that does not conform to or comply with provisions of the Plan, the Settlement Trust Agreement or the Litigation Trust Agreement. Notwithstanding this section 17.4, each Non-Settling Tort Claimant will be entitled to continue or commence an action against the Trustees of the Litigation Trust (in their capacity as Trustees only and not in their individual capacity) in which the Non-Settling Tort Claimant will be entitled to a jury trial for the sole purpose of obtaining a judgment as permitted by the Litigation Trust Agreement, thereby liquidating such Non-Settling Tort Claimant’s Claim so that it may be paid with other Allowed Tort Claims in the ordinary course of the operations of the Litigation Trust, consistent with the provisions of the Litigation Trust Agreement. The holder of any such judgment will be enjoined from executing against the Litigation Trust or its assets. In the event any Person takes any action that is prohibited by, or is otherwise inconsistent with the provisions of Article 17 of the Plan, then, upon notice to the Court by an affected Party, the action or proceeding in which the Claim of such Person is asserted will automatically be transferred to the Court (or, as applicable, the District Court) for enforcement of the provisions of Article 17 of the Plan. The foregoing injunctive provisions are integral part of the Plan and are essential to its implementations.

See *In re The Roman Catholic Church of the Diocese of Tucson*, Case No. 4-0404721 (BK Az), Debtor’s Plan of Reorganization dated September 20, 2004, at 43-45.

Final resolution of tort claims is the shared objective of the holders of these claims and the third parties such as insurers and co-defendants. The bankruptcy court has an important role in the efforts of the parties to achieve this goal. These parties must work creatively within the parameters of the Bankruptcy Code to produce a resolution which will address their concerns.

Parties, however, must be cognizant, of the Second Circuit admonition in the latest *Manville* decision: “A court’s ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions.” *In re Johns-Manville Corporation*, 517 F.3d 52, 66 (2nd Cir. 2008).

Conclusion

Mass tort claims present some unique players, roles and responsibilities for bankruptcy courts and practitioners. In the end, negotiation and settlement are the objectives. The challenge is to reach a resolution which will be sustained if challenged. Recently, in the *Johns Manville* case, the Second Circuit vacated an order of the district court on the scope of the channeling injunction or jurisdictional grounds and remanded the matter to the bankruptcy court. See *In re Johns Manville Corporation*, 517 F.3d 52 (2d Cir. 2008). In its final footnote the Second Circuit noted:

Travelers asserts that if any portion of the bankruptcy court’s clarifying order is vacated then all of the relevant settlements will terminate. We offer no opinion on this matter and leave it to the parties, with the aid of the bankruptcy court, to determine the status of their settlement.

Id. at 68.