Class Actions and Bankruptcy

Presented by the April Pupilage Team
Led by Rick Cobb and Jim Carignan

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Wilmington, Delaware 19801

DELAWARE BANKRUPTCY INN OF COURT

APRIL 17, 2012 PUPILAGE PROGRAM:
CLASS ACTIONS AND BANKRUPTCY

Team Leaders: Rick Cobb and Jim Carignan

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DELAWARE BANKRUPTCY INN OF COURT

APRIL 17, 2012 PUPILAGE PROGRAM: CLASS ACTIONS AND BANKRUPTCY

Subtopic I - Class Action Basics

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I. Reasons For Class Actions

A. Class actions serve two fundamental purposes. First, if there is a sufficient number of people with substantially similar claims against substantially the same group of defendants, it is more efficient and less taxing on the judicial system and litigants to have all the claims adjudicated in one proceeding.

B. Second, if the claims of one person or a small group do not have sufficient economic magnitude to make individual litigation financially feasible, aggregating their claims with those of other similarly situated persons allows aggrieved individuals to have a day in court.

II. Class Actions Are Governed By Federal Rule Of Civil Procedure 23

A. Class actions in Adversary Proceedings are governed by Fed.R.Civ.P. 23. Fed.R.Bankr.P. 7023.

B. The standards for class actions are set out in subparts (a) and (b) of Rule 23. To maintain a lawsuit as a class action, a plaintiff must demonstrate to the Court that the case satisfies each of the four prerequisites of Rule 23(a) and at least one of the standards of Rule 23(b).

C. **Rule 23(a)**

1. The four prerequisites of Rule 23(a) are commonly referred to as numerosity (Rule 23(a)(1)), commonality (Rule 23(a)(2)), typicality (Rule 23(a)(3)), and adequacy of representation (Rule 23(a)(4)).

2. Numerosity -- Rule 23(a)(1)

a. An initial task for the class action attorney is to define the class. The class must be defined with sufficient precision so the Court can assess the requirements of Rule 23, so who is or is not (i) entitled to a share of any award or (ii) bound by any judgment, whether favorable or adverse, can be readily determined.

b. The numerosity requirement then asks whether there are sufficient members of the defined class to warrant invoking the class action mechanism. For example, if there are only a handful of potential members, say fewer than 10, the case likely is more easily managed as a multi-plaintiff action.

c. There is no fixed definition of what number of class members is necessary or sufficient. Generally, a proposed class with fewer than 21 members is insufficiently numerous, and one with more than 40 members satisfies the requirement. A class with as few as 17 members has been approved, *Allen v. Isaac*, 99 F.R.D. 45 (N.D. Ill. 1983), and numbers as high as 54 have been determined to be insufficiently numerous. *Moore v. Trippe*, 743 F. Supp. 201 (S.D.N.Y. 1990).

d. While the sheer number of potential members is the most important factor for numerosity, a court may consider others, including judicial economy from avoiding multiple actions, the geographic dispersion of the class members, and whether or not the proposed class members might be capable of mounting individual actions.

3. Commonality – Rule 23(a)(2)

a. The commonality requirement asks whether there are material issues in the case that are substantially the same for all members of the proposed class.

b. This requirement promotes the goal of efficiency. Are there questions of law or fact sufficiently similar among class members such that an adjudication with regard to one or a few effectively and fairly resolves the claims of all members?

c. Commonality does not mean that every issue in the case has to be the same for all class members. It can be sufficient if a few or even one issue is common to the class so long as the answers to the common questions "drive the resolution of the litigation." *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. _____, 131 S.Ct. 2541, 2551 (2011). The "common contention . . . must be of such a nature . . . that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims. . . ." *Id.*

d. Some factual differences among class members' claims do not preclude a finding of commonality. For example, a need for individualized determinations of damages suffered by each class member does not negate commonality.

e. Rule 23(c)(4) permits a litigation to be maintained as a class action with respect to particular issues only.

f. Rule 23(c)(5) permits the Court to divide a class into subclasses. This procedure may be useful where subgroups of a class have common issues different from other subgroups.

4. Typicality – Rule 23(a)(3)

a. While commonality focuses on the class as a whole, typicality focuses on the proposed class representative. Typicality seeks to assure that the representative plaintiff's interest is substantially similar to the interests of absent class members.

b. Typicality generally means that the class representative's claims must arise from the same events, practices or conduct and are based generally on the same legal theories as the claims of other members of the class.

c. Critical to typicality is a determination that there are no significant conflicts or antagonisms (in underlying facts or legal theory) between the class representative's claims and those of absent class members.

d. As with commonality, a complete identity of claims is not necessary. Rather the question is whether the class

representative's claims have substantially the same characteristics as those of other class members.

e. If, however, there are material factual differences between the representative's claims and those of other class members, establishing typicality may be difficult. A common problem in this regard is whether there is a unique defense against the class representative that is central to the representative's ability to demonstrate personal entitlement relief.

f. A predominant issue that is not common to class members can defeat typicality. For example, common law fraud claims are generally not regarded as suitable for class action treatment because each class member may not have received identical information and in any event, each would have to demonstrate reliance on the allegedly false statements.

5. Adequacy of Representation – Rule 23(a)(4)

a. This requirement also focuses on the class representative – will the named representative fairly and adequately protect the interests of absent class members?

b. This requirement has a constitutional dimension. If absent class members are to be bound by a judgment in the class action, due process requires that their interests must be adequately represented by the class representative.

c. The class representative is deemed to be a fiduciary for the class. The class representative therefore cannot have any material conflict of interest. For example, the class representative cannot be a golfing buddy of or have a social or business relationship with any defendant.

d. Disagreements about the desirability of bringing the action or the theories on which the action should be brought do not give rise to a conflict sufficient to defeat adequacy.

e. If there is a defense unique to the class representative that is so central to the case that it may divert the class representative's attention, it may defeat adequacy. Examples are a

credibility issue or that the plaintiff responded to the defendants' allegedly wrongful conduct in a manner inconsistent with the contention that the conduct was wrongful.

f. Since the class representative is supposed to act as the client and assert a litigant's interest as distinct from counsel's, the class representative should not be affiliated with class counsel. For example, a class representative cannot be a partner of, an associate in the law firm of, an employee of, or a close relative of class counsel. E.g., *Kramer v. Scientific Control Corp.*, 543 F. 2d 1085 (3d Cir. 1976).

g. Another possible conflict may arise if the class representative has a claim against a defendant that is separate and distinct from the class claim; there may be a temptation to trade relief on the class claims for greater recovery on the individual claim.

h. The class representative must also ensure vigorous prosecution of the litigation. He or she should be able to demonstrate some familiarity with the action and the nature of the claims so that he/she can meaningfully act as a client and interact constructively with counsel. Inability to participate meaningfully in the action , for example, through poor health or lack of mental capacity, may render a plaintiff inadequate.

i. Adequacy of counsel is an important aspect of adequacy of representation. Class counsel's ability to represent the class vigorously and effectively must also be established.

j. Previously the class representative's financial capacity was deemed relevant to adequacy. More recently, the class representative's ability to pay expenses is no longer relevant since it is permissible for class counsel to undertake to finance the litigation on a contingent basis. Delaware Lawyers' Rules of Professional Conduct 1.8(e)(1).

D. **Rule 23(b)**

1. Rule 23(b)(1)(A) – prosecution of separate actions will prejudice the party opposing the class.

a. There must be a realistic possibility of separate litigations.

b. There must be a plausible risk that separate litigations would have inconsistent results.

c. A common situation for application of this rule is where the party opposing the class has a pre-existing obligation to treat class members in a similar fashion, such as an employer or fiduciary.

2. Rule 23(b)(1)(B) – prejudice to class members resulting from prosecution of separate actions.

a. One situation for application of this subpart would be where adjudication of an individual claim would have a collateral estoppel or even a precedential effect on similar claims of other class members. Some courts, however, have rejected effect on subsequent litigation as a basis for invoking this subpart.

b. Another example would be where class members' claims collectively total more than the limited fund available to satisfy them.

3. Rule 23(b)(2) – injunctive or declaratory relief.

a. This subpart is fairly straightforward. It generally applies where a plaintiff is seeking injunctive or declaratory relief with respect to the class as a whole.

b. This section permits a single litigation to determine the propriety of conduct for the party opposing the class.

c. "The key to the (b)(2) class is 'the indivisible nature of the injunctive or declaratory remedy warranted – the notion that the conduct is such that it can be enjoined or declared unlawful only as to all of the class members or as to none of them.'. . . In other words, Rule 23(b)(2) applies only when a single injunction or declaratory judgment would provide relief to each member of the class." *Wal-Mart Stores, Inc. v. Dukes, supra*, 131 S.Ct. at 2557. Monetary damages are generally not available in a (b)(2) action. *Id.*

4. Rule 23(b)(3) – generally applies to cases seeking money damages.

a. The plaintiff must show that the questions of law or fact common to the class predominate over questions affecting individual members and that the class action is superior to other available methods of resolving the dispute.

b. Determining predominance generally involves pragmatic assessment of the issues in the litigation. It does not mean that there are more common issues than individual issues, but rather whether the Rule 23 goal of litigation efficiency will in fact be achieved.

c. Generally, individual issues regarding damages do not adversely affect predominance.

d. Differences in state laws applicable to various class members' claims, even though not sufficient to preclude commonality, may defeat predominance. E.g., *Mazza v. American Honda Motor Co., Inc.*, 666 F.3d 581 (9th Cir. 2012).

e. The superiority requirement generally involves consideration of alternative means of resolving the dispute and comparing the efficiency and fairness of the alternatives to a class action process.

f. Rule 23(b)(3) includes a number of relevant criteria for the Court's consideration.

III. PROCEDURE

A. Pre-filing

1. Counsel must consider the Rule 23 factors and determine whether they can be satisfied.

2. This includes having a sufficient discussion with the client to develop a level of confidence that the client is willing and able to act for others. The client must understand that the case is not conducted solely for his or her benefit, but rather for the benefit of absent class members. Thus, for example, the client must understand that bringing a class action means

that any recovery for him/her will be pro rata the same as for other class members. After a case is certified as a class action, the class representative cannot extract a bonus or settle his or her claim separately from the class.

3. The plaintiff also needs to understand that he or she will likely have to participate in discovery.

4. The complaint must allege facts sufficient to comply with the Rule 23 requirements. It will include a section of class action allegations tracking the rule.

5. The filing a class action tolls the running of the statute of limitation on claims of individual class members until certification is denied. *American Pipe & Const. Co. v. Utah*, 414 U.S. 538, 94 S.Ct. 756 (1974); *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345, 103 S.Ct. 2392 (1983).

B. Class Certification

1. Class certification should occur early in a litigation. *See* Rule 23(c)(1)(A). In many cases, however, the class certification motion is not brought until the case is well into discovery or, at times, almost ready for trial.

2. The party seeking certification, generally the plaintiff, submits a motion for class certification. The motion defines the class and seeks through briefs and affidavits to demonstrate compliance with the requirements of Rule 23(a) and one of the categories of Rule 23(b).

3. It is the plaintiff's burden to plead compliance with Rule 23 and ultimately to establish through the motion for class certification that the requirements of the rule are satisfied.

4. Courts generally permit discovery on class certification issues, usually of the plaintiff. The plaintiff generally cannot get merits discovery on class certification.

5. Class certification is often contested and the party opposing certification will submit briefs and affidavits in support of its position.

6. The Court may hold an evidentiary hearing.

7. In the context of class certification, the Court may not conduct a preliminary inquiry into the merits of the case with a view to which side may ultimately prevail. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-178, 94 S.Ct. 2140, 2152-53 (1974). It may, however, consider facts, i.e. more than the mere allegations of the pleadings, to the extent necessary to determine whether or not the requirements of Rule 23 are met. *Wal-Mart Stores, Inc. v. Dukes, supra*, 131 S.Ct. at 2551.

8. If the Court determines to certify a class, it enters a class certification order which sets out in detail compliance with the standards of Rule 23, defines the class on behalf of which the action is brought, and appoints class representatives and class counsel. *See* Rules 23(c) and 23(g).

9. Like any other interlocutory order, a class certification order may be amended or a class decertified at any time before final judgment. *See* Rules 23(c)(1)(C).

10. A class certification order may be the subject of a discretionary interlocutory appeal. *See* F.R.Civ.P. 23(f). The standard for appellate review of a class certification order generally is abuse of discretion. *E.g., Hoxworth v. Blinder, Robinson & Co., Inc.*, 980 F.2d 912, 923 (3d Cir. 1992).

C. Notice and Opt Out

1. In actions certified under Rule 23(b)(3), Rule 23 requires notice to the class and an opportunity for class members to opt out.

2. When a class is certified under subsections (b)(1) or (b)(2), notice is discretionary. Rule 23(c)(2)(A). There is no opt-out, unless the principal relief sought is money damages. *Phillips Petroleum v. Shutts*, 472 U.S. 797, 811-812, 105 S.Ct. 2965, 2974 (1985); *Wright v. National Football League*, 41 F.3d 402, 407 (8th Cir. 1994). In practice, unless there is insufficient time for notice, class certification orders under these subparts generally provide for notice to absent class members.

3. The Court must approve the notice. The notice generally describes the action, its factual and legal basis, the parties, the relief sought

and, in actions certified under Rule 23(b)(3), what a class member needs to do to opt out if he or she so desires, and the consequences of remaining in the action or opting out.

4. The notice must be "the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." Rule 23(c)(2)(B). This generally requires notice by first class mail directly to class members who can be identified. *Phillips Petroleum v. Shutts*, *supra*, 472 U.S. at 812, 105 S.Ct. at 2975. Publication notice is often the best notice practicable when class members cannot be identified or located specifically through reasonable efforts. *E.g., In re Warfarin Sodium Antitrust Litigation*, 391 F.3d 516, 536-37 (3d Cir. 2004).

5. The class proponent, generally the plaintiff, must bear the cost of providing the notice. *Eisen v. Carlisle & Jacquelin*, *supra*, 417 U.S. at 177, 94 S.Ct. at 2152.

D. Settlement

1. As a result of the 2003 amendments to Rule 23, prior to class certification, a plaintiff who brought his or her claim as a purported class action is free to settle on an individual basis without judicial supervision. *See* Rule 23(e): "Claims, issues, or defenses of a *certified* class may be settled, voluntarily dismissed or compromised only with the Court's approval." [Emphasis added.]

2. After class certification settlements require Court approval. F.R.Civ.P. 23(e). Class-wide settlements may be negotiated before the class is certified; the parties then ask the Court to certify a class in the context of the settlement approval process.

3. The parties enter into a detailed settlement agreement that is subject to Court approval. The agreement recites, *inter alia*, the consideration, the releases defendants are to receive, and the mechanics of distribution of any settlement fund.

4. The settlement agreement is generally submitted to the Court along with a proposed order to schedule a hearing on the settlement and a proposed notice to class members.

5. In federal practice, courts generally engage in preliminary approval. That is, the parties submit briefs in support of the settlement along with the settlement agreement, and the Court makes an initial determination that the settlement may merit approval. The Court enters an order scheduling a hearing on the settlement and directing that notice be sent to class members. Fed.R.Civ.P. 23(e)(1). Unlike the class certification notice, which must be the "best notice practicable under the circumstances," Fed.R.Civ.P. 23(c)(2)(B), notice of a proposed settlement or voluntary dismissal must be given "in a reasonable manner." Fed.R.Civ.P. 23(e)(1).

6. Like the class certification notice, the notice of settlement will describe the nature of the claims and defenses, and the factual and legal theories of the case, and the parties. In addition, the notice describes the proposed settlement consideration; in general terms the parties' reasons for entering into the settlement; what a class member needs to do if he or she wishes to object to the settlement; the date, time and place of the settlement hearing; and the date by which any objections must be submitted.

7. At or prior to a settlement hearing, the parties will submit an evidentiary record developed through discovery, including deposition transcripts and significant documents, and may also provide additional affidavits. Parties also generally submit briefs in support of the settlement describing the strengths and weaknesses of the claims and defenses, and explaining why the settlement is a fair and adequate compromise of the litigation.

8. Class members may object to the proposed settlement, and submit evidence and/or briefs supporting their position.

9. To approve a settlement that binds class members, the Court must determine, based on the submitted record, that the settlement is "fair, reasonable and adequate." Fed.R.Civ.P. 23(e)(2). The Court may not modify the terms of the settlement agreement' rather it must approve or disapprove the settlement as a whole. It may, however, disapprove a settlement while indicating to the parties certain changes that, if made, will result in approval.

10. An objector may appeal court approval of a class action settlement. The standard of review on appeal is abuse of discretion. *E.g., In re GMC Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 782 (3d Cir. 1995). A class member need not intervene as a party litigant before appealing; having submitted an objection is sufficient to confer standing to appeal. *Devlin v. Scardelletti*, 536 U.S. 1, 122 S.Ct. 2005 (2002).

11. Because class counsel take on a fiduciary obligation to the class separate and independent from that of the representative plaintiff, counsel has a duty to act independently in good faith on behalf of all members of the class, and may present a proposed settlement over the objections of a named plaintiff. *In re M&F Worldwide Corp. S'holders Litig.*, 799 A.2d 1164 (Del. Ch. 2002); *Lazy Oil Co. v. Witco Corp.*, 166 F.3d 581 (3d Cir. 1999).

IV. RESOURCES

A. Conte & Newburg, *Newburg on Class Actions* (4th ed. 2002).

B. *Moore's Federal Practice* (3rd ed.) Chapter 23.

DELAWARE BANKRUPTCY INN OF COURT

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CLASS ACTIONS AND BANKRUPTCY

Subtopic II – Overlay of Bankruptcy Procedures on Class Actions

Subgroup led by: Rick Cobb
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1. Class Action Claim Settlements

a. Plan Settlements

i. Channeling Injunctions Pursuant to 11 U.S.C. § 524(g) providing for Future Claimant Trusts in Asbestos-Related Cases

1) 11 U.S.C. § 524(g) went into effect in 1996; 524(g) was essentially the codification of the authority the *Johns-Manville* court adduced from § 105(a) to issue channeling injunctions in asbestos-related cases; the enactment of § 524(g) was not intended to modify the rights of bankruptcy courts to issue equitable injunctions pursuant to § 105(a). *See* 140 Cong. Rec. H10752–01, H10766 (1994) (Section 524(g) "is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan [of] reorganization . . . . The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved.")

2) "§ 524(g) [is] designed to protect the interests of future claimants whose claims are permanently enjoined. Among these, the plan must be approved by a super-majority of current claimants, and must provide substantially similar treatment to present and future claimants. Furthermore, the court must appoint a futures representative to act as fiduciary for the interests of future claimants. *See* 11 U.S.C. §§ 524(g)(2)(B)(ii)(IV)(bb), 524(g)(4)(B)(I), 524(g)(2)(B)(i)(V)." *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 237 (3d Cir. 2004); *In re Grossman's, Inc.*, 607 F.3d 114, 127 (3d Cir. 2010).

3) A future claimant trust must be funded in whole or in part by the securities of one or more debtors involved in the plan and by the obligation of the Debtor to make future payments, including dividends. § 524(g)(2)(B)(i)(II).

ii. Channeling injunctions pursuant to 11 U.S.C. § 105(a)

1) Equitable remedy, modeled on 11 U.S.C. § 524(g) asbestos future claimant trust

2) § 105(a) has been used to support a channeling injunction in cases where the mass tort liability does not arise from contact with asbestos. *See SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992) (authorizing channeling injunction for securities class action claims); *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648 (6th Cir. 2002) (authorizing channeling injunction for silicone breast implant claims); *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694 (4th Cir. 1989) (authorizing channeling injunction for Dalkon Shield birth control device claims).

3) General powers of § 105(a) cannot be used to achieve a result not contemplated by the more specific provisions of § 524(g); *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 237 (3d Cir. 2004)

iii. Due process issues/concerns (how does the plan treat future claimants)

1) Does the class representative adequately represent future claimants?

a. It is imperative for future claimants to be "adequately represented throughout the reorganization process." *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 245 (3d Cir. 2004)

2) If class action claims arise from the purchase or sale of the debtor's securities, the claims will be subordinated under § 510(b)

a. Reasoning is that stockholders assumed risk of business failure by investing in equity rather than debt instruments; *see In reTelegroup Inc.*, 281 F.3d

133, 141 (3d Cir. 2002), *In re Enron Corp.*, 341 B.R. 141 (Bankr. S.D.N.Y. 2006)

b. § 510 constructed liberally, based on legislative history, to justify subordination where claimants have assumed risk of loss

iv. Procedures for obtaining approval of a class action settlement as part of a plan

1) Class action settlements can be conditioned upon approval of a separate plan of reorganization – that is, settlement approval is essential to reorganization; in that case, each must be reviewed separately and receive separate judicial approval; *In re Drexel Burnham Lambert Group*, 130 B.R. 910 (S.D.N.Y. 1991).

2) Certification of class settlement is reviewed under Fed. R. Civ. P. 23 and Bankruptcy Rule 9019; *In re Drexel Burnham Lambert Group*, 130 B.R. 910 (S.D.N.Y. 1991). "The legal standard for determining the propriety of a bankruptcy settlement is whether the settlement is in the best interests of the estate. To determine that a settlement is in the best interests of the estate, the Supreme Court held in *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414 (1968), that the settlement must be fair and equitable." *In re Adelphia Communs. Corp.*, 368 B.R. 140, 225 (Bankr. S.D.N.Y. 2007) (internal quotations omitted). "Under the 'fair and equitable' standard, [the court looks] to the fairness of the settlement to the other parties, i.e., the parties who did not settle." *In re Wash. Mut., Inc.*, 442 B.R. 314, 328 (Bankr. D. Del. 2011) (citing *Will v. Northwestern Univ. (In re Nutraquest, Inc.)*, 434 F.3d 639, 645 (3d Cir. 2006)). "The court does not have to be convinced that the settlement is the best possible compromise, but only that the settlement falls within a reasonable range of litigation possibilities." *Id.*

3) In *Drexel*, the settlement included an injunction barring suits against the officers and directors of the debtor (i.e., non-debtors). The Second Circuit upheld the injunction against suits against non-debtors, 960 F.2d at 293, because "[i]n bankruptcy cases, a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization

plan." *Id.* at 293; *see also In re A.H. Robins Co.,* 880 F.2d 694, 701 (4th Cir.), *cert. denied,* 110 S.Ct. 376 (1989) (upholding injunction barring suits against debtor's directors and outside counsel and debtor's insurer and its outside counsel because such suits "would affect the bankruptcy reorganization in one way or another such as by way of indemnity or contribution."); *but see In re Johns-Manville Corp.,* 517 F.3d 52 62 (2d Cir. 2008) (injunction barring asbestos claimants from suing an insurer of Johns-Manville for claims based on insurer's breach of its own duty to the claimants exceeded the bankruptcy court's jurisdiction, because those claims did not directly affect the *res* of the bankruptcy estate).

1) Estimation of class claims - expert testimony and statistical models

    a. Section 502(c) of the Bankruptcy Code provides for the estimation of contingent or unliquidated claims for the purpose of allowance if the liquidation of such claims would unduly delay the administration of the case.

    b. Use of historical data to predict current and future liability

    c. Questionnaires and Claim Forms

    d. Bellwether Trials: lift stay selectively to permit full trials of a representative sampling of the aggregated claims; not very common valuation methodology, but the concept was endorsed by the court in *In re Dow Corning Corp.*, 211 B.R. 545 (Bankr. E.D. Mich. 1997). "If liability is found at the general causation stage, the sampling process could begin with the development of a detailed informational questionnaire that each claimant would be required to complete. The completed questionnaires would be used to divide the tort claimants into appropriate subgroups. Next, a random sample of tort claimants would be chosen from each subgroup. The number chosen would have to be sufficient to create statistically relevant results that could then be extrapolated to the rest of the members of the subgroup. Each of the

randomly selected tort claimants would then receive a jury trial. Based on the jury findings, linear regression equations would be developed. If the process is determined to be an estimation, the juries could even be asked to decide questions not specific to the individual plaintiffs before them." 211 B.R. at 597.

e. Court-appointed Experts – court can use Rule 706 to enlist help from expert

2) Classification

f. It is permissible and fairly common to classify aggregated claims separately; on the case of a settled class action, separate classification may be a condition of the settlement

g. If a class action has not settled, or if settlement contains no terms relating to classification, then the usual statutory standards and strategic considerations will govern classification of the claim.

3) Voting and Confirmation

h. Questions arise as to: (i) who is entitled to vote; (ii) whether the vote of a class claim constitutes a single vote or multiple votes (i.e., whether the class of claims that includes the class claim has accepted the plan under the requirements of 11 U.S.C. § 1126(c)); (iii) how votes are to be weighted.

i. Class representatives can vote on behalf of class members who don't vote individually, but not on behalf of class members who voted on their own behalf. *In re Mortgage & Realty Trust,* 125 B.R. 575, 583 (Bankr. C.D. Cal. 1991).

j. Does a class claim count as a single vote or multiple votes?

i. Important for the "one-half in number" requirement for acceptance by a class of claims pursuant to 11 U.S.C. § 1126(c)

ii. It appears that no court has directly addressed this issue. One court, in dicta,

noted that "there is support (albeit without addressing the question head on) for counting the [...] class claim as one vote." *In re Frascella Enterprises, Inc.,* 360 B.R. 435, 453 (Bankr. E.D. Pa. 2007).

k. If each class member gets to vote individually, then how do you weigh each vote?

i. Important for the "two-thirds in amount" requirement of 11 U.S.C. § 1126(c)

ii. giving equal weight to each vote raises fairness concerns because not every claim may be of equal value, but distinguishing between the claims may be impractical, and the court may be forced to estimate the claim of each individual within the class. *See In re Dow Corning Corp.,* 211 B.R. 545, 573 (Bankr. E.D. Mich. 1997) ("Assuming that the implant claims were temporarily allowed for the purposes of voting on the plan, the Court would still have to determine how much each such claim is worth. Obviously, a claimant with no discernible illness should not have a claim equal in amount to another claimant who is suffering grievously. The estimation would then become extremely protracted as the Court would have to review the alleged symptoms of hundreds of thousands of claimants. [...] Because of the significant effort that estimation of this type would require, it is not an effort which should even be begun unless the need is real.").

iii. Courts have not found any "real need" to address this issue head-on.

4) Due Process - Rule 23(e)(1) requires that "[t]he court must direct notice in a reasonable manner to all class members who would be bound by the proposal."

l. Individual notice should be given to all class members who can be identified with reasonable effort. *Pigford v. Veneman,* 355 F.Supp.2d 148,

162 (D. D.C. 2005) ("If all (or most) class members can be individually identified and located, courts will require that individual notice be sent via mail or other direct means."); *see Eisen v. Carlisle & Jacquelin,* 94 S.Ct. 2140, 2151 (1974); *DeJulius v. New England Health Care Employees Pension Fund,* 429 F.3d 935, 943 (10th Cir. 2005).

m. Notice must be sent sufficiently in advance of the settlement approval hearing to afford class members an opportunity to be heard. *Torrisi v. Tucson Elec. Power Co.,* 8 F.3d 1370, 1374 (9th Cir. 1993), *cert. denied,* 114 S.Ct. 2707 (1994); *In re Agent Orange Prod. Liab. Lit.,* 597 F.Supp. 740, 759 (E.D.N.Y. 1984).

b. Settlement outside of a plan

i. Legal Standards for Approval of Class Action Settlements in Bankruptcy Court

1) Approval under Fed. R. Civ. P. 23(e) and Bankruptcy Rule 9019

a. Settlement of a class action in the context of bankruptcy should meet both the standards for settlement under Rule 23(e) for federal class actions and under Bankruptcy Rule 9019(a). In re Am. Family Enters., 256 B.R. 377, 429 (D.N.J. 2000) (approving class action settlement pursuant to Rule 23 and Bankruptcy Rule 9019); In re Worldcom, Inc., 347 B.R. at 139-40 (applying both Rule 23 and Bankruptcy Rule 9019 to approve a class action settlement).

2) Approval under Fed. R. Civ. P. 23(e)

a. In determining the fairness of a class action settlement under Rule 23(e), the bankruptcy court may consider a variety of factors, including: (i) the complexity, expense and likely duration of the litigation; (ii) the reaction of the class to the settlement; (iii) the stage of the proceedings and the amount of discovery completed; (iv) the risks of establishing liability; (v) the risks of establishing damages; (vi) the risks of maintaining

the class action through the trial; (vii) the ability of the defendants to withstand a greater judgment; (viii) the range of reasonableness of the settlement fund in light of the best possible recovery; and (ix) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation. See In re Ins. Brokerage Antitrust Litig., 579 F.3d 241, 258 (3d Cir. 2009) (quoting Girsh v. Jepson, 521 F.2d 153, 157 (3d Cir. 1975)).

3) Approval Under Bankruptcy Rule 9019

a. Approval of a settlement under Bankruptcy Rule 9019 is committed to the sound discretion of the bankruptcy court. Key3Media Group, Inc. v. Pulver.com, Inc. (In re Key3Media Group, Inc.), 336 B.R. 87, 92 (Bankr. D. Del. 2005). The Court, however, should defer to the debtor's business judgment when approving consensual settlements. See In re Coram Healthcare Corp., 315 B.R. 321, 330 (Bankr. D. Del. 2004).

b. Bankruptcy courts generally approve settlements that are "fair, reasonable, and in the best interests of the estate." In re Louise's, Inc., 211 B.R. 798, 801 (D. Del. 1997). In determining whether to approve a settlement pursuant to section 363 of the Bankruptcy Code and Bankruptcy Rule 9019, a bankruptcy court is required to "assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal." Myers v. Martin (In re Martin), 91 F.3d 389, 393 (3d Cir. 1996)

c. Four factors Court's consider when deciding whether to approve a proposed settlement: "(1) the probability of success in the litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors." Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424-25 (1968); Will v. Northwestern Univ. (In re

Nutraquest, Inc.), 434 F.3d 639, 644 (3d Cir. 2006) (confirming the Martin factors as a longstanding test for approval of settlements); In re Marvel Entm't Group, Inc., 222 B.R. 243, 249 (D. Del. 1998) (relying on these four factors to determine fairness, reasonableness, and adequacy of a settlement).

d. "The court must also consider 'all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise.'" In re Marvel Entm't Group, Inc., 222 B.R. at 249 (quoting TMT Trailer Ferry, Inc., 390 U.S. at 424). The court may approve the settlement so long as it is "above the lowest point in the range of reasonableness." In re TSIC, Inc., 393 B.R. at 79 (quoting Official Unsecured Creditors' Comm. v. Pa. Truck Lines, Inc. (In re Pa. Truck Lines, Inc.), 150 B.R. 595, 598 (E.D. Pa. 1992)).

ii. Procedures for obtaining approval of a class action settlement pursuant to 9019 – Class action settlements are usually approved in a two step process: preliminary approval prior to notice to the class and final approval following a period during which class members may object to the settlement.

1) STEP 1:

a. File motion seeking entry of an order preliminarily approving the settlement and –

i. certifying the class for settlement purposes only;

1. Fed. R. Civ. P. Rule 23(a) requires a showing of (1) numerosity; (2) commonality; (3) typicality; and (4) adequacy of representation.

ii. appointing class representatives and class counsel;

1. Appointment of class counsel pursuant to Rule 23(g)

a. Appoint counsel to represent the class and to effectuate the

settlement and resolution of the class claims.

2. Provide for award of attorneys' fees to Class Counsel pursuant to Rule 23(h)

    a. Third Circuit courts evaluate attorneys' fee awards in common fund settlement cases based on a non-exhaustive list of factors: (1) the size of the fund created and number of persons benefitted; (2) the presence or absence of substantial objections by members of the class to the settlement terms and/or fees requested by counsel; (3) the skill and efficiency of the attorneys involved; (4) the complexity and duration of the litigation; (5) the risk of nonpayment; (6) the amount of time devoted to the case by plaintiffs' counsel; and (7) the awards in similar cases. In re AT&T Corp. Secs. Litig., 455 F.3d 160, 165 (3d Cir. 2006)

3. approving the form, manner, and content of notice for the Settlement Class and related claims administration procedures; and

    a. Appointment of Claims Processor / Administrator to implement claims process and noticing procedures

    b. Notice Procedures

        i. Fair, adequate and sufficient notice for purposes of informing all Settlement Class

members of the class certification and settlement, and permitting such members to participate in the claims-made process, opt-out of the settlement, or object to the settlement in compliance with Rule 23 and due process considerations.

ii. Form of Notice

iii. Publication Notice

iv. Undeliverable Notices / Deficiency Notices

4. scheduling the final fairness hearing.

2) STEP 2:

a. After entry of the preliminary order, and implementing the approved claims process and noticing procedures in full compliance with the Court's preliminary order, file a motion seeking entry of an order –

i. approving the settlement on a final basis;

ii. reaffirming class certification, class representatives and class counsel appointments, and noticing procedures; and

iii. approving (final approval) the settlement.

2. Preserving Class Action Claims in Bankruptcy

a. Filing a Proof of Claim.

i. The Federal Rules of Bankruptcy Procedure provide that a proof of claim cannot be filed by anyone other than the creditor, an authorized representative of that creditor or an indenture trustee. Fed. R. Bankr. P. 3001(b). If the creditor does not timely file a proof of claim, the debtor or trustee may file a proof of claim on the creditor's behalf. Fed. R. Bankr. P. 3003. See also 11 U.S.C. § 501 which provides, in relevant part:

> (b) If a creditor does not timely file a proof of such creditor's claim, an entity that

> is liable to such creditor with the debtor, or that has secured such creditor, may file a proof of such claim.
> (c) If a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim.

ii. If not certified prepetition, a putative class may request the Bankruptcy Court to file a class proof of claim and grant class certification.

iii. Standing. Before addressing the elements of Rule 23(a) and (b), a court must determine whether a legally definable class that has standing exists. See, e.g., In re Chiang, 385 F.3d 256, 271 (3d Cir. 2004). Debtors may constitute a class. In In re Young, 1994 WL 88992 (Bankr. E.D. Pa., Mar. 11, 1994), several chapter 13 debtors attempted to certify a class of existing and prospective bankruptcy debtors. The nominal chapter 13 debtors proposed to certify a class "consisting of all those persons to whom a notice from the Pennsylvania Department of Public Welfare ("DPW") was addressed . . . demanding payment of a food stamp overpayment debt allegedly owed to DPW, and who were threatened with having their case referred to the Internal Revenue Service for possible tax intercept, and who have in the past, or may in the future, file a petition for relief under the Bankruptcy Code." Id. at *1. The proposed class plaintiffs sought to challenge the sufficiency of the procedures adopted by the DPW to avoid IRS interceptions where the claimant had filed bankruptcy and therefore stayed or discharged the interceptions. The DPW opposed certification in part on the basis it had voluntarily cured the named Plaintiffs' grievances and therefore mooted their arguments. The Court found this argument "not very appealing." Id. at *2. Rather, the Court found that such an argument "reinforces the validity of the very reason that the Plaintiffs seek to utilize the class device, i.e., that the [DPW]'s general practices will evade review because the [DPW] will take care of any particular parties with a just grievance who consult the Plaintiffs' counsel, but wish to be free to utilize the challenged practices as to all others." Id. Finding all other requirements of Fed. R. Civ. P. 23 satisfied, the Bankruptcy Court certified the class.

iv. Court discretion. The issue of whether or not to permit a proof of claim is left to the discretion of the Bankruptcy Court. See,

e.g., In re American Reserve Corp., 840 F.2d 487, 492 (7th Cir.1988); In re United Companies Fin. Corp., 276 B.R. 368, 372 (Bankr. D. Del. 2002).

v. Applicability of Rule 7023. In order to have a valid class proof of claim, a proponent of a class proof of claim must seek and obtain a determination from the bankruptcy court that Rule 7023 is applicable to the claims resolution process. See In re Circuit City Stores, Inc., 2010 WL 2208014 at *3 (May 28, 2010 Bankr. E.D. Va.), *aff'd*, In re Circuit City Stores, Inc., 2010 WL 4481781 (Oct. 29, 2010 E.D. Va.), *affirmed*, In re Circuit City Stores, Inc., — F.3d —-, 2012 WL 310870 (4th Cir. 2012). (Feb. 2, 2012); In re Computer Learning Centers, Inc., 344 B.R. 79, 86-87 (Bankr. E.D. Va. 2006) ("The applicability of Rule 7023 is raised by motion . . . [T]he proponent of the class proof of claim must seek and obtain application of Rule 7023 . . . [W]ithout that order, Rule 7023 is not applicable to the proof of claim and a class proof of claim is improper."); American Reserve Corp., 840 F.2d at 488 ("[T]he right to file a proof of claim on behalf of a class seems secure, at least if the bankruptcy judge elects to incorporate Rule 23 via Rule 7023 via Rule 9014.") (emphasis added); Reid v. White Motor Corp., 886 F.2d 1462, 1470-71 (6th Cir. 1989) (finding that a class proof of claim was not permissible without an order making Bankruptcy Rule 7023 applicable). See also, In re Tarragon Corporation, 2010 WL 3842409 (Bankr. D.N.J., Sept. 24, 2010). In Tarragon, the claimant timely filed 5 class proofs of claim against the Debtor. After the Debtor's chapter 11 plan was confirmed, the Debtor moved to expunge the class proofs of claim. The claimant asserted that her proofs of claim met the requirements of Fed. R. Civ. P. 23, and that she was not permitted to seek class certification unless and until an objection was raised to the claim. The Bankruptcy Court for the District of New Jersey rejected the claimant's arguments and expunged the proofs of claim. While noting that the 11th Circuit had held that a motion for class certification could not be filed until there was an objection to a class proof of claim, citing In re Charter Co., 876 F.2d 866 (11th Cir. 1989), the Court noted earlier New Jersey Bankruptcy Court decisions had found motions for class certification to be timely when filed *with* a proof of claim. See In re First Interregional Equity Corp., 227 B.R. 358 (Bankr. D. N.J. 1998). Noting that the "pervasive theme is avoiding undue delay in the administration

of the case," (citations omitted), the Tarragon court found that the claimant's delay was not only inexcusable, but would work substantial prejudice on the Debtor and its estates. The putative class both named and unnamed had received actual notice of the bar date from KCC. Moreover, the Debtor had already confirmed its plan with the support of its creditors, and had begun to implement the plan. Allowing the class proofs of claim – filed in the amount of $50 million – "would inflict unjustifiable harm on the Defendants and their other creditors." Tarragon at *5.

1) Prior to filing the Class Claim, seek the necessary authorization and approval from the Court as required by the Bar Date Order and Bankruptcy Rule 9014 to have Bankruptcy Rule 7023 apply to the Class Claim. There is no time requirement stated within which Rule 23 must be invoked in a bankruptcy context. See, e.g., In re Charter Co., 876 F.2d at 894. However bankruptcy courts have found that the timing for making such a request is significant. See, e.g., In re Sacred Heart Hospital of Norristown, 177 B.R. 16, 23 (Bankr. E.D. Pa. 1995). See also Spring Ford Indus., 2004 WL 231010 at *4. A motion to allow the filing of a class claim will not be untimely if filed concurrently with the proof of claim; First Interregional Equity Corp., 237 B.R. 358, 366 (Bankr. D. N.J. 1998).

2) In order to obtain class certification, a plaintiff must satisfy the two-pronged inquiry of Fed. R. Civ. P. 23, made applicable to bankruptcy proceedings by Fed. R. Bankr. P. 7023.

vi. Requirements of Fed. R. Civ. P. 23(a) and (b)

1) First, a case may be certified as a class action if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class;(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class. Fed. R. Civ. P. 23(a).

2) If the four requirements of Rule 23(a) are satisfied, the class action must further meet one of the requirements outlined in Rule 23(b). See, e.g., Scott v. University of

Delaware, 601 F.2d 76, 84 (3d Cir. 1979). (*Generally discuss Rule 23(b)).*

b. Eligibility. If would be class claimants fail to comply with the required procedures, they are ineligible to file class proofs of claim. Without a court order, Rule 7023 is not applicable to the proof of claim and a class proof of claim is improper. See, e.g., In re Computer Learning Centers, Inc., 344 B.R. 79, 85 (Bankr. E.D. Va. 2006).

c. Law Applicable to Rule 23(a) and (b) review.

   i. The application of Rule 23 requires "rigorous analysis to ensure that class certification is appropriate." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 594 n.13 (2007) (quoting General Tel. Co. of Southwest v. Falcon, 457 U.S. 147, 161 (1982)) (noting that a "court may not certify a class without ruling that each Rule 23 requirement is met, even if a requirement overlaps with a merits issue"). This rigorous analysis requires a court to "find that the evidence more likely than not establishes each fact necessary to meet the requirements of Rule 23." In re Hydrogen Peroxide Antitrust Litig., 552 F.3d 305, 320 (3d Cir. 2008).

   ii. Courts "construe the requirements of Rule 23 liberally, particularly when the determination of the propriety of the class action is being made at an early stage of the proceedings . . . ." Scott, 601 F.2d at 92 n.15; see also Brown v. Cameron-Brown Co., 92 F.R.D. 32, 49 (E.D. Va. 1981) ("Generally, there appears to be an acceptance that where doubts exist as to the advisability of proceeding with a class action they should be resolved in favor of class certification.").

   iii. The Third Circuit has indicated that class actions should be looked upon favorably. Eisenberg v. Gagnon, 766 F.2d 770, 785 (3d Cir. 1985), cert. denied, Wasserstrom v. Eisenberg, 474 U.S. 946 (1985) (noting that for claims based on securities laws, "[c]lass actions are a particularly appropriate and desirable means to resolve claims"); Spark v. MBNA Corp., 178 F.R.D. 431, 434 (D. Del. 1998).

   iv. Even if all the elements of Rule 23(a) and (b) are met, class certification can be denied for lack of need: Certification is unnecessary if all the class members will benefit from an injunction issued on behalf of the named plaintiffs. Kansas Health Care Ass'n v. Kansas Dep't of Social & Rehabilitation Servs., 31 F.3d 1536, 1548 (10th Cir. 1994); Stuart v. Hewlett-Packard Co., 66 F.R.D. 73, 77 (E.D. Mich. 1975) ("Even after

the threshold determination is made that a class action is an appropriate device, the inquiry should proceed to determine if, under the circumstances, it is the most appropriate device.").

d. Class actions are permissible in numerous factual and procedural instances. For example, courts have permitted class actions in non-dischargeability adversary proceedings. In response to a Debtor's challenge to a class non-dischargeability complaint, the Bankruptcy Court for the District of New Jersey held that class actions are permitted even for non-dischargeability complaints. In In re Iommazzo, 149 B.R. 767 (Bankr. D. N.J. 1993), purchasers of stock in a chapter 7 debtor corporation brought a non-dischargeability action against an individual debtor who owned the accounting firm that had audited the corporate debtor. The basis of the non-dischargeability claim was fraud. The individual debtor opposed the complaint, arguing that the class complaint violated 11 U.S.C. § 523(c) – which allows a bankruptcy court to consider an exception to discharge only when the complaint is filed by "the creditor to whom such debt is owed" – because it "would allow for a creditor to seek the determination of the dischargeability of someone else's claim." Citing Sweet v. Hanson, 104 B.R. 261 (Bankr. N.D. Cal. 1989). The New Jersey bankruptcy court found that Fed. R. Bankr. P. 7023 broadly applied to adversary actions, and that non-dischargeability claims were not excepted. The Court further relied upon United States Supreme Court precedent in Califano v. Yamasaki, 442 U.S. 682, where the Supreme Court had indicated that a class action under Section 205(g) of the Social Security Act could be maintained notwithstanding that the provision referenced suits by an "individual."

e. Opting Out of a class.

   i. In In re Jevic Holding Corp., 2010 WL 3431985 (Bankr. D. Del., Aug. 27, 2010), a question arose as to the effectiveness of an election by 143 class members to opt-out of a class certified by the Bankruptcy Court. In Jevic, 143 purported class members did not follow the procedures for exercising their rights to opt out of the class. Rather, New Jersey counsel for the 143 class members sent a letter to class counsel in the bankruptcy case, purporting to opt-out the 143 members from the class. At the time the letter was received, class counsel filed a declaration in the Bankruptcy Court expressing his opinion that the opt-out was ineffective. Over a year later, Sun Capital Partners, Inc. sought clarification of whether the 143 were members of the class. Class counsel as well as the Debtor's

counsel, joined with Sun Capital's position, arguing that the opt-out by counsel on behalf of the 143 members was ineffective. Recognizing that "Courts generally apply some measure of flexibility in recognizing a potential class member's desire to opt-out of a class" (citations omitted), the Court noted that there was no dispute that New Jersey counsel's letter was unambiguous and authentic. The Court also noted, however, that "the pleadings and representations of counsel raise substantial concerns regarding whether the 143 Individuals intend to participate in this adversary class action." Jevic at *3. The Court therefore directed that the parties solicit in writing each of the 143 members, and specifically have each party indicate their individual intention whether to opt-out.

Questions for discussion:

Has the Third Circuit addressed class certification in bankruptcy?

Yes, there was a pre-Code decision by the Third Circuit, Securities and Exchange Comm. v. Aberdeed Secs. Co., Inc., 480 F.2d 1121 (3d Cir. 1973), in which the Court struck down a request to certify a class where it found that "[a]ll creditors were given notice of the insolvency proceedings, and they were given an opportunity to file claims." Id. at 1128. The Court further noted that the proceeding was a liquidation "which should be concluded as expeditiously as possible. We see no indication that a class action designation would have such a result. The petitioners failed to show that the method they advocated was superior to the procedures being followed by the Bankruptcy Court." Id. It is probably best to be cautious in citing Aberdeen as authority for any proposition, as it was issued prior to the Supreme Court promulgating the Federal Rules of Bankruptcy Procedure in 1983 (which, of course, includes Rule 7023). Further, at the time of Aberdeen, few if any courts recognized the value of, and permitted the filing of, class claims. The balance began to change with the Seventh Circuit's 1988 decision in American Reserve.

Is there a common consensus among lower courts in the Third Circuit? In Delaware?

Not really. Decisions whether to allow claims are very fact specific. In In re Sacred Heart Hospital of Norristown, 177 B.R. 16 (Bankr. E.D. Pa. 1995), Judge Scholl denied a motion for leave to file a class proof of claim for former employees. In re Tarragon Corporation, 2010 WL 3842409 (Bankr. D.N.J., Sept. 24, 2010) (expunging class proofs of claim). On the other hand, other courts have permitted proofs of claim. See, e.g., In re Zenith Laboratories, 104 N.R. 659 (D.N.J. 1989), and In re Spring Ford

Indus, Inc., 2004 WL 231010 (Bankr. E.D.Pa. Jan. 290, 2004), allowing the filing of a class proof of claim

In Delaware, Judge Walrath has issued three decisions addressing class proofs of claim. In the first, In re Kaiser Group, Int;'l, Inc., 278 B.R. 58 (Bankr. D. Del. 2002), the Court allowed a class claim for 47 claimants because the Court found that there were common questions of fact and law which arose from the same course of conduct and the adjudication of the common issues which predominate would promote judicial economy and efficiency. In allowing the class claim, Judge Walrath expressly found that the amount of damages to be recovered by each class member was relatively small, particularly in light of the likely recovery for creditors under the Debtor's plan. In the second case, In re United Companies Fin. Corp., 276 B.R. 368 (Bankr. D. Del. 2002), the Court granted the right to file a class proof of claim, even though the debtor stated that there were individual issues among the claims, including counterclaims by the debtor against the claimants. The Court found that the individual claims and legal issues will be secondary to common questions of fact and law, and the court found that there was no better method to adjudicate the claims against the debtor than from a class action. In so finding the court noted that it is probable that many of the proposed class claimants were unaware of the right sights and that the amounts to be received were relatively small, thereby rendering prosecution of their claim to be cost-prohibitive. Further, and notably, Judge Walrath took note of the omnibus claims objection process used in the district which permits a debtor to file an omnibus objection to claims on a common ground and the claimants' responses are dealt with at that hearing. The Court found that, if individual issues are raised with respect to claims, the Court could deal with those issues at the hearing to consider the objection or reschedule those specific issues to be considered at separate hearings. And in the third, In re United Companies Financial Corp., 277 B.R. 596 (Bankr. D. Del. 2002), the court denied allowance of a class claim where it found that there were too many individual facts and issues to make the administration of the claims issues efficient and manageable.

Many courts that have considered whether or not to permit a class proof of claim have expressly cited whether or not the class was already certified in another proceeding. Generally, prior certification weighs heavily in favor of permitting a class proof of claim as there is already a representative of the interests. Interestingly, in neither Kaiser nor United Companies did Judge Walrath consider whether or not the class of claimants had been previously certified.

Three other decisions from Delaware are from the case of W.R. Grace & Co. See W.R. Grace & Co., 389 B.R. 373 (Bankr. D. Del. 2008), aff'd by

2008 WL 4234339(D. Del. 2008). See also 398 B.R. 368 (D. Del 2008) (denying motion for reconsideration). In W.R. Grace, the Bankruptcy Court denied and the District Court affirmed a request for a class proof of claim. Among the facts that the courts evaluated were the national publication of the bar date and the class certification would ultimately render the bar date useless, adversely affecting those who timely filed their proof of claim.

What are the benefits of class certification?

- Where common issues of fact and law predominate, the Court can address the parties' issues in a single, efficient manner.

- Where either (i) the claimants' claims are small or (ii) claimants are unaware of their claims, it is more likely that valid claims will be pursued if the Court permits a class proof of claim to be filed, thereby facilitating the goal of bankruptcy to compensate creditors through an equitable distribution.

- Permitting class proofs of claim is consistent with the general purposes of Rule 23 of the Federal Rules of Civil Procedure.

What are the drawbacks to class certification?

- There is less of a need to proceed by filing class proofs of claim in bankruptcy than elsewhere, since the purpose of a class action is to resolve claims effectively. expeditiously and in a single forum, which is similar to the bankruptcy process.

- There is a lesser need for class certification than there is in other cases because the bankruptcy process provides for public notification. Unnecessary, given noticing for bar dates.

- Costs of counsel for claimants imposes an additional burden on the estate, thereby reducing distribution to creditors.

- Adds additional complications to the process of claims resolution, where local rules may already provide for the mechanism of claims through an omnibus claims objection process.

- Permitting the filing of a class proof of claim undermines the fixing of a bar date at the expense of creditors who timely filed proofs of claim.

Any Practice Pointers?

Seek class certification early in the bankruptcy case. As noted by the court in Sacred Heart, timing is significant. "The most propitious time for filing a motion for class recognition is before a bar date is established, since the bar date is effectively uprooted in part by an extension of the bar date for a favored class of creditors." 177 B.R. at 23. See also Spring Ford Indus., 2004 WL

231010 at *4. A motion to allow the filing of a class claim may be timely if filed concurrently with the proof of claim. See, e.g., First Interregional Equity Corp., 237 B.R. 358, 366 (Bankr. D. N.J. 1998).

Almost every case addressing a class proof of claim, addresses the requirements under Rule 23 (i.e., numerosity, common questions of law or fact, that claims or defenses are typical, and adequate representation). The last requirement relates not only to the class representative, but to counsel, and proposed Counsel should also be prepared to evidence its ability to represent the class' interest. Sacred Heart, 177 B.R. at 23-24, In re United Companies Financial Corp., 277 B.R. at 605). Counsel should be prepared to address how litigation of claims as a class proof of claim vs. individual proofs of claim is in the best interests of judicial economy. In re United Companies Fin. Corp., 276 B.R. at 370. Such inquiry may include whether the claimants' claims are so small or whether the claimants know about their rights and, therefore will be less likely to pursue their own claims. See, e.g., Kaiser Group, Int;'l., 278 B.R. at 67; Zenith Laboratories, Inc., 104 B.R. 659, 662 (D. N.J. 1989) (citing American Reserve Corp., 840 F.2d at 489). Where there are a significant number of individualized issues, there is a greater likelihood that the Court would find that adjudication would be inefficient and unmanageable and therefore a class claim would not be preferred to individualized claims. In re United Companies Financial Corp., 277 B.R. at 607.

3. Like many things in bankruptcy, it is best practice to ask the debtor (and the committee, if there is one) to consent to class certification.

DELAWARE BANKRUPTCY INN OF COURT

APRIL 17, 2012 PUPILAGE PROGRAM:
CLASS ACTIONS AND BANKRUPTCY

Subtopic III – Ethical Considerations

Subgroup led by: Adam Hiller
Participants: Brian Arban, Tom Horan, Ryan Murphy, Anthony Saccullo, Sommer L. Ross and Matthew Ward

I. CLASS AS A CLIENT.

A. Who is the client?

1. Unnamed plaintiffs are not clients pre-certification.

a. Delaware Rule of Professional Conduct 1.7 Adopts Comment to Model Rules of Professional Conduct 1.7: "When a lawyer represents or seeks to represent a class of plaintiffs or defendants in a class-action lawsuit, unnamed members of the class are ordinarily not considered to be clients of the lawyer for purposes of applying paragraph (a)(1) of this Rule. Thus, the lawyer does not typically need to get the consent of such a person before representing a client suing the person in an unrelated matter. Similarly, a lawyer seeking to represent an opponent in a class action does not typically need the consent of an unnamed member of the class whom the lawyer represents in an unrelated matter."

b. *Schick v. Berg,* 430 F.3d 112, 116-17 (2nd Cir. 2005): "Until a trial court determines that all prerequisites to certification are satisfied, there is no class action, the case proceeds as an ordinary lawsuit, and attorneys for named class members have no authority to represent or otherwise act on behalf of the unnamed class members. Under these circumstances, we decline to hold that named plaintiffs' attorneys owe a precertification duty to unnamed class members."

2. In a certified class, the lawyer has fiduciary obligations to all class members.

a. *In re Corn Derivatives Antitrust Litigation,* 748 F.2d 157 (3rd Cir. 1984): "The obligation of counsel representing a class runs to the class as a whole, although as a general matter class counsel may have worked closely only with the named parties." *Accord Greenfield v. Villagers Industries, Inc.,* 483 F.2d

824, 832 (3rd Cir. 1973) ("class action counsel possess, in a very real sense, fiduciary obligations to those not before the court").

b. The duty of notification and duty to keep informed are of particular importance. *Greenfield v. Villagers Industries, Inc., supra*: "Not the least important of the fiduciary duties shared by counsel and the court is their duty to ensure that absentee class members have knowledge of proceedings in which a final judgment may directly affect their interests. An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."

c. "Notices are usually the only way to communicate with unnamed class members and enable them to make informed decisions about whether to participate in a settlement. Your primary goals are that notice reach as many class members as possible, preferably by individual notification (see Rule 23(e)(1)(B) and MCL 4th § 21.312), and that the recipients notice it, recognize its connection to their lives and self-interests, read it, and act on it. In a world in which junk mail and spam can easily drown out important messages, you may need to press the parties to look beyond the formal legal requirements and find a way to communicate the gist of a class action notice in an attention-getting and understandable format. Rule 23(c)(2)(B) commands that notices 'concisely and clearly state in plain, easily understood language' the elements of class action notices." ROTHSTEIN, BARBARA J. & THOMAS E. WILLGING, MANAGING CLASS ACTION LITIGATION: A POCKET GUIDE FOR JUDGES, 18-19 (Federal Judicial Center 2005):

3. In a certified class, the lawyer has fiduciary obligations to all class members. Local counsel is jointly obligated with lead counsel to class. Huber v. Taylor, 469 F.3d 67 (3rd Cir. 2006): The Third Circuit held that local counsel and outside counsel had a joint obligation in relation to fiduciary duties owed to a client. Lead counsel could be held liable for the failure of local counsel to properly disclose certain material aspects of a settlement agreement and vice versa.

4. Lead class plaintiff has fiduciary obligations to individual class members. *Kline v. Wolf,* 702 F.2d 400, 403 (2nd Cir. 1983): In upholding the district court's denial of class certification owing to proposed lead plaintiff's issues with credibility, the Second Circuit held that class representatives are fiduciaries of the class as a whole and that the class is dependent upon a plaintiff's "diligence, wisdom and integrity."

5. Because the class lawyer acts in the best interest of the class, a lawyer may continue to represent a class even with dissenting members. *Lazy Oil Co. v. Witco Corporation,* 166 F.3d 581, 590 (3rd Cir. 1999): Class action settlement approval over objections of lead class plaintiff and denial of motion to disqualify class counsel upheld by the Third Circuit. The Third Circuit held that "once some class representatives object to a settlement agreement negotiated on their behalf, class counsel may continue to represent the remaining class representatives and the class, as long as the interest of the class in continued presentation by experienced counsel is not outweighed by the actual prejudice to the objectors of being opposed by their former counsel" These factors include: 1) the information in the attorney's possession; 2) the availability of the information elsewhere; 3) the importance of the information to the disputed issues; 4) actual prejudice that could flow from the attorney's possession of the information; 5) the costs to class members of obtaining new counsel and the ease with which they might do so; 6) the complexity of the litigation; 7) and the time needed for new counsel to familiarize himself with the case.

B. Intra-Class Conflicts.

1. Class actions (in or out of bankruptcy) have a high likelihood of giving rise to the possibility of intra-class disputes. *See, e.g., In re Painewebber Ltd. P'ships Litig.*, 171 F.R.D. 104, 123 (S.D.N.Y. 1997) ("Potential conflict between class members is often a danger in large class actions.").

2. One benefit of bankruptcy is its ability to handle massive class action constituencies effectively, whereas outside of bankruptcy, cases may be derailed as a result of disputes between class members. *See, e.g., Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997) (affirming Third Circuit Court of Appeals' decision to vacate class certification, based largely on actual or potential intra-class disputes); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999).

3. In bankruptcy proceedings, the Bankruptcy Court is given broad discretion in allowing or disallowing a class representative to act on behalf of the class as a whole. *See, e.g., In re Tronox Inc.*, Case No. 09-10156 (ALG), at p. 5 (Bankr. S.D.N.Y. May 6, 2010) (unpub.) (stating that a class representative may file a proof of claim on behalf of a class even before appointed as class representative in the underlying litigation, because the bankruptcy court's and the underlying court's decisions are independent (citing cases)).

4. Not many published opinions have addressed intra-class disputes in the bankruptcy context. At least one bankruptcy court has suggested

that the same means of resolving any such disputes outside of bankruptcy apply equally in bankruptcy. *See Broadhollow Funding Corp. v. Fitzmaurice (In re Broadhollow Funding Corp.)*, 66 B.R. 1005, 1010 (Bankr. E.D.N.Y. 1986) (stating that "Congress provided for intraclass conflict by including (c)(4)(B) in Rule 23. F.R. Civ. P. 23(c)(4)(B) states: 'When appropriate: . . . . a class may be divided into subclasses and each subclass treated as a class and the provisions of this rule shall then be construed and applied accordingly.'"). In that case, the Bankruptcy Court agreed to certify a class of approximately 1,000 investors in the debtor, and certified a subclass consisting of approximately 600 of those investors whose names were associated with mortgages held by the debtor. *Id.* at 1014.

5. May a class take action as a class, notwithstanding intra-class disputes?

a. Generally courts conclude that intra-class dissent, in itself, is not a sufficient basis to inhibit conduct taken by a class. *See County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1325 (2nd Cir. 1990) (stating that even majority opposition might not be enough to derail a settlement if class members enjoy the right to opt out); *Cotton v. Hinton*, 559 F.2d 1326, 1333 (5th Cir. 1977) (employee class action settlement approved over objection of counsel claiming to represent almost half the class); *Bryan v. Pittsburgh Plate Glass Co.*, 494 F.2d 799, 803 (3rd Cir. 1974) (settlement approved over objections by more than a fifth of the class), *cert. denied*, 419 U.S. 900 (1974); *Mezyk v. U.S. Bank Pension Plan*, Case Nos. 3:09 cv 384 JPG & 3:10 cv 696 JPG, 2011 U.S. Dist. LEXIS 13857, at *24 (S.D. Ill. Feb. 11, 2011) (certifying class of over 8,000 pension plan participants, and finding that although it was "theoretically possible" that some putative class members' interests could be opposed to the requested relief, "at the class certification hearing, U.S. Bank was unable to point to a single putative class member who is actually in this situation"); *cf. In re Alstom SA Sec. Litig.*, 253 F.R.D. 266, 276 (S.D.N.Y. 2008) (certifying class, because typicality is defeated only upon a showing of actual intra-class conflicts that relate to the very subject matter of the suit).

b. However, if discord is sufficiently pronounced, the bankruptcy court may decide to take protective measures. *See Broadhollow*, 66 B.R. at 1010 ("The court may *sua sponte* divide the class into subclasses when important rights are at stake." (citing cases)). That approach is consistent with courts outside of the bankruptcy context as well. *See, e.g., E. Tex. Motor Freight Sys., Inc. v. Rodriguez*, 431 U.S. 395, 405 (1977) (class certification not proper when a majority of the class members had rejected the relief sought by the named plaintiffs); *Georgine Prods. Inc. v. Amchem Prods. Inc.*, 83 F.3d 610, 632 (3d. Cir.

1995) (remanding with directions to decertify class and vacate injunction, because "we conclude that serious intra-class conflicts preclude this class from meeting the adequacy of representation requirement"), *aff'd sub nom. Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997); *Davis v. Roadway Express, Inc.*, 590 F.2d 140, 144 (5th Cir. 1979) ("overwhelming vote of opposition"); *Peterson v. Okla. City Hous. Auth.*, 545 F.2d 1270, 1273 (10th Cir. 1976) (opposition by many class members); *see also Spano v. Boeing Co. and Beesley v. Int'l Paper Co. (consolidated cases)*, 633 F.3d 574 (7th Cir. 2011) (vacating certification of two classes of defined-contribution plan participants, because the district court failed (among other things) to define the classes narrowly to prevent intra-class conflicts that might arise); *see generally Williams v. Gen. Elec. Capital Auto Lease, Inc.*, 159 F.3d 266, 269-70 (7th Cir. 1998) (explaining how intra-class conflicts can arise and turn adequacy of representation from adequate to inadequate).

c. Additionally, in bankruptcy cases, class participants enjoy added protections of the provisions of the Bankruptcy Code (for example, the prohibition on unfair discrimination in a cram-down, the technicalities of section 524(g) in asbestos cases, etc.).

6. May counsel represent a class, notwithstanding intra-class disputes?

a. Rule 1.7 of the Rule of Professional Conduct states:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> (1) the representation of one client will be directly adverse to another client; or
>
> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
>
> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

b. Rule 1.8(g) states: "A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients . . . unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement."

7. Numerous articles have addressed counsel's ethical obligations in the event of a dispute within a class. The following are examples:

a. Geoffrey P. Miller, Conflicts of Interest in Class Action Litigation: An Inquiry into the Appropriate Standard, NYU Center for Law & Business Working Paper Series CLB-03-011 (found at http://w4.stern.nyu.edu/emplibrary/03-011.pdf).

b. S. Elizabeth Gibson, Case Studies of Mass Tort Limited Fund Class Action Settlements & Bankruptcy Reorganizations?, Federal Judicial Center (2000) (found at http://bulk.resource.org/courts.gov/fjc/masstort.pdf).

c. Lester Brickman, Ethical Issues in Asbestos Litigation, 33 Hofstra L. Rev. 833 (2005).

II. REPRESENTING THE CLASS

A. Retention/appointment as class counsel & disclosure obligations under Fed. R. Bankr. P. 2019

1. Rule 2019 was revised as of December 1, 2011. It now requires that "a verified statement setting forth the information specified in subdivision (c)

of this rule shall be filed by every group or committee that consists of or represents, and every entity that represents, multiple creditors or equity security holders that are (A) acting in concert to advance their common interests, and (B) not composed entirely of affiliates or insiders of one another." Rule 2019(b)(1)." The revisions limit the effect of Rule 2019 in certain significant respects. Now there is a disclosure requirement where the group or committee represented is "acting in concert."

2. Revised Rule 2019(b)(2) provides a carveout for a class action representative. Specifically, it provides: "Unless the court orders otherwise, an entity is not required to file the verified statement described in paragraph (1) of this subdivision solely because of its status as: . . . (C) a class action representative . . . ." Rule 2019(b)(2)(C). Therefore, there is no automatic Rule 2019 disclosure requirement for class counsel.

3. The rule appears to leave open the possibility that a court could require disclosure by class counsel. Prior caselaw under 2019, as it related to class actions, is therefore of limited applicability.

B. Client communications—how a lawyer can communicate (and not communicate) with class clients?

1. Delaware Rule Of Professional Conduct 1.4 provides:

> (a) A lawyer shall:
>
> (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
>
> (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
>
> (3) keep the client reasonably informed about the status of the matter;
>
> (4) promptly comply with reasonable requests for information; and
>
> (5) consult with the client about any relevant limitation on the lawyer's conduct when the

lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

2. The Manual for Complex Litigation (4th ed. 2011), "used by the judges of this court as a resource for managing complex cases," contains a section devoted to Precertification Communications with the Proposed Class. (See § 21.12, reproduced in the appendix). According to the Manual, "[d]irect communications with class members . . . whether by plaintiffs or defendants, can lead to abuse."

3. Even though the rule does not contain any reference to communications, courts have interpreted Fed. R. Civ. P. 23(d) to provide for the trial court's authority "to issue orders to prevent abuse of the class action process." *In re Sch. Asbestos Litig.,* 842 F.2d 671, 680 (3rd Cir. 1988). The Manual cites this decision to suggest that "Rule 23(d) authorizes the court to regulate communications with potential class members, even before certification." Manual for Complex Litigation § 21.12 (4th ed. 2011).

4. In *Gulf Oil Company v. Bernard,* 452 U.S. 89, 101 S. Ct. 2193, 68 L.Ed.2d 693 (1981) (see appendix), the defendant in a discrimination class action lawsuit was contacting potential class members before the class was certified and arranging for payoffs and releases. Class counsel wanted to contact those same people and stop them from settling with the defendant, by (allegedly) making promises that the amounts awarded to class members would be higher. The Supreme Court announced that it was legally permissible for the district court to prohibit class counsel from contacting its own potential class members, so long as the prohibition was embodied in "a carefully drawn order that limits speech as little as possible, consistent with the rights of the parties under the circumstances." *Id.* at 102. The Supreme Court found that a complete gag order was not permissible, but the district court could have tailored an order to protect against dangerous communications without abridging the First Amendment. There is a lot of case law interpreting this decision.

5. A lawyer may communicate with potential class members before litigation in an effort to determine their interest in forming or participating in a class. Newburg on Class Action Ethics § 15:4 (4th ed. 2011). But these communications should not involve "drumming up" class participation by filing uninvestigated claims. *In re Shell Oil Refinery,* 152 F.R.D. 526, 530 (E.D. La. 1989). These communications should also not be inflammatory. *Reed v. Sisters Of Charity Of Incarnate Word Of La.,* 447 F. Supp. 309, 320 (W.D. La. 1978)

(imposing a fee-shifting burden upon counsel for the class when the class claim failed, because "the record further clearly reflects that the inflammatory speech of lead counsel on February 26, 1976, approximately one month prior to filing this suit, was instrumental in fomenting this litigation").

6. Once litigation has begun, the lawyer may respond to inquiries initiated by potential class members. Newburg on Class Action Ethics § 15:12 (4th ed. 2011).

7. Just as a lawyer may treat class members and sometimes potential class members as a clients, the ethical rules relating to the lawyer for an adverse party speaking with a represented person's client may also apply. Newburg on Class Action Ethics § 15:14 (4th ed. 2011) (citing the Code of Professional Responsibility's conditional prohibition on the lawyer's communication with a represented party). Moreover, while it is improper for a defendant to use a campaign of threats or uncontrolled discussions with potential or actual class members to deter them from participating in the class, at least one court has held that the lawyer who blessed "truthful and noncoercive" communications between the defendant and class members was subject to sanctions. *Kleiner v. First Nat. Bank of Atlanta,* 751 F.2d 1193, 1197 (11th Cir. 1985) (the bank's lawyer was fined for conduct described as follows: "Meeting with top Bank managers . . ., [the lawyer] advised that a communications scheme would be lawful under the precepts of Bernard v. Gulf Oil Co. as long as the conversations were truthful and noncoercive. The lawyer warned that any such campaign, while legal, would be an extraordinary move likely to provoke the wrath of the court. He outlined the risks the Bank might court, including an injunction against further contacts, cancellation of the exclusion requests, and an order to issue corrective notice at Bank expense.").

8. A lawyer communicating with a class member about a proposed class settlement should not coerce the class member into accepting a settlement that may "[sacrifice] her interests . . . in order to achieve a settlement that was good for the class attorney but bad for [the class member] . . . ." *Ficalora v. Lockheed California Co.,* 751 F.2d 995, 997 (9th Cir. 1985) (overturning the trial court's order approving an employment discrimination class settlement agreement that provided, among other things, that the defendant did not have to rehire Ms. Ficalora specifically).

III. COMPENSATION OF CLASS COUNSEL

A. Payment of attorney's fees represent a source of friction between the interests of class members and class counsel given the inherent conflict between an attorney's interest in being compensated and the class members' interest in maximizing their respective recoveries. Given the potential for ethical violations, the applicable rules apply numerous checks in regulating the compensation of class counsel. In addition to specific rules of civil and bankruptcy procedure, the ethical standards set forth in the Model Rules mandate that an attorney keep his or her financial interests separate from those of the client and that no attorney may charge or collect an unreasonable fee. *Model Rules of Professional Conduct* 1.7, 1.5.

B. Compensation of Professionals. Neither the Federal Rules of Civil Procedure or the Federal Rules of Bankruptcy Procedure provide an independent basis for compensating class counsel. Rather, any right to an award of fees or costs must come from substantive law applicable to the class action. *See* 5-23 *Moore's Federal Practice*, Civil § 23.124 (2011). The two generally applicable bases for the award of attorney's fees and costs are (1) statutes that provide a mechanism for fee-shifting, and (2) creation of a common fund based on the equitable principles of quantum meruit and unjust enrichment. *See id.*; *see, e.g.*, 15 U.S.C. § 15 (prevailing plaintiff in private suit enforcing damages resulting from antitrust violation entitled to recover reasonable attorney's fees); *Boeing Co. v. Van Gemert*, 444 U.S. 472, 480-82 (1980) (upholding common fund doctrine that when efforts of attorney create fund against which persons receive a benefit, attorney is entitled to award of reasonable compensation from that fund). Courts apply two-broadly accepted methods for determining the amount of a reasonable award of attorney's fees: (1) the Percentage-of-Funds Method, and (2) the Lodestar Approach. 5-23 *Moore's Federal Practice*, Civil § 23.124.

1. Percentage-of-Funds Method. The percentage-of-funds approach involves calculation of the fees based on a percentage of the value of the common fund that is created, which is adjusted depending on the application of a number of relevant factors. In the Third Circuit, the percentage-of-funds method is generally favored because it awards fees from the fund in a manner that rewards class counsel for success while also penalizing it for failure. See generally In re AT & T Corp., 455 F.3d 160, 164 (3rd Cir. 2006) ("In common fund cases ... the percentage-of-recovery method is generally favored because it allows courts to award fees from the fund in a manner that rewards counsel for success and penalizes it for failure.") (internal quotation marks omitted); see also In re Rite Aid Corp. Sec. Litig., 396 F.3d 294, 300 (3rd Cir. 2005). The following factors are to be applied in awarding attorneys' fees under the percentage-of-funds method:

(1) the size of the fund created and the number of persons benefitted;
(2) the presence or absence of substantial objections by members of the class to the settlement terms and/or fees requested by counsel;
(3) the skill and efficiency of the attorneys involved;
(4) the complexity and duration of the litigation;
(5) the risk of nonpayment;
(6) the amount of time devoted to the case by plaintiffs counsel; and
(7) the awards in similar cases.

See Gunter v. Ridgewood Energy Corp., 223 F.3d 190, 195 n. 1 (3rd Cir. 2000); *Segen v. OptionsExpress Holdings, Inc.*, 631 F. Supp. 2d 465, 469-70 (D. Del. 2009).

2. Lodestar Method. Under the lodestar approach, the number of hours reasonably expended by counsel are determined by the court. That number is then multiplied by a reasonable hourly rate based on the given geographical area, the nature of the services provided, and the experience of the attorneys, to obtain the lodestar. See 5-23 Moore's Federal Practice, Civil § 23.124. The lodestar method is mandatory in instances where the right to attorney's fees arises from a federal fee-shifting statute. *Id.; Gisbrecht v. Barnhart*, 535 U.S. 789, 802 (2002). Even where attorney's fees are calculated based on percentage of a common fund, the Third Circuit has instructed that an abbreviated version of the lodestar method be applied in order to "to cross-check the reasonableness" of the proposed fee. *In re AT & T*, 455 F.3d at 164; Segen, 631 F. Supp. 2d at 479-80.

C. Court Review and Approval of Fees.

1. Regardless of whether the percentage-of-funds or lodestar approach is used to calculate class counsel fees, any award is subject to court review for reasonableness. Federal Rule of Bankruptcy Procedure 7023 incorporates Rule 23 of the Federal Rules of Civil Procedure in all adversary proceedings. Fed. R. Bankr. P. 7023. Federal Rule of Bankruptcy 9014 gives the bankruptcy court discretion to apply Rule 7023 in contested matters. 10 Lawrence P. King, et al., Collier on Bankruptcy ¶ 7023.01, at 7023–2 (rev. 16th ed. 2011) ("Collier"). Rule 23 provides for an award of fees and nontaxable costs to class counsel, and in certain instances, to other attorneys that have provided a demonstrable benefit to the class. Rule 23(h); Collier, ¶ 7023.01, at 7023–27. Rule

23 does not affect which method of calculation of fees is appropriate in setting a reasonable attorney's fee. Fed. R. Civ. P. 23(h).

2. Rule 23(h) provides that "[i]n a certified class action, the court may award reasonable attorney's fees and nontaxable costs that are authorized by law or by the parties' agreement." Id. The following procedural requirements apply when awarding attorney's fees in a class action:

(1) A claim for an award must be made by motion under Rule 54(d)(2), subject to the provisions of Rule 23(h), at a time the court sets. Notice of the motion must be served on all parties and, for motions by class counsel, directed to class members in a reasonable manner.

(2) A class member, or a party from whom payment is sought, may object to the motion.

(3) The court may hold a hearing and must find the facts and state its legal conclusions under Rule 52(a).

(4) The court may refer issues related to the amount of the award to a special master or a magistrate judge, as provided in Rule 54(d)(2)(D). *Id.*; see generally *Collier*, ¶ 7023.09, at 7023–27. Federal Rule of Bankruptcy Procedure 7054 does not explicitly incorporate the provisions of Rule 54(d). It is not uniformly accepted that Rule 54(d)(2) is applicable in bankruptcy proceedings solely because on Bankruptcy Rule 7023 incorporates Rule 23 "in its entirety." See *Collier*, ¶ 7023.09, at 7023–29 ("[S]ince Rule 7023 incorporates Rule 23 in its entirety, Rule 54(d)(2) is applicable in bankruptcy, but only with respect to class actions."); In re Partsearch Techs., Inc., 453 B.R. 84, 104 (Bankr. S.D.N.Y. 2011) (noting that the view espoused in Collier is not uniform). Furthermore, Bankruptcy Rule 7008(b) provides that "[a] request for an award of attorney's fees shall be pleaded as a claim in a complaint, cross-claim, third-party complaint, answer, or reply as may be appropriate." Fed. R. Bankr. P. 7008(b). Since there is some question over whether Rule 54(d) is applicable in bankruptcy, the safer procedure is for an attorney to set forth a separate claim requesting compensation as class counsel. See *Partseartch*, 453 B.R. at 104 (citing Howard J. Steinberg, Bankruptcy Litigation, § 5:176 (2d ed. 2007 & Supp. 2010)).

3. In determining the reasonableness of fees, either when calculated under the percentage-of-funds or lodestar approach, the following factors are considered by courts under Rule 23(h):

(1) the result actually achieved for class members;

(2) the directions or orders the court may have placed in the retention order appointing class counsel;

(3) agreements among the parties regarding the fee motion and agreements between class counsel and others about the fees sought; and

(4) evidence of fees charged by class counsel or other attorneys for representing individual claimants or objectors in the case.

See Collier, ¶ 7023.09[1], at 7023–28. The reasonableness requirement is at least facially similar in nature to the test applied for compensation of professionals under section 330 of the Bankruptcy Code in considering "what services a reasonable lawyer or legal firm would have performed in the same circumstances." *In re Ames Dep't Stores, Inc.*, 76 F.3d 66, 72 (2nd Cir. 1996) (citing *In re Taxman Clothing Co.*, 49 F.3d 310, 315 (7th Cir. 1995). Thus, while retention and approval of fees under section 330 is technically a separate procedural matter, class action litigators retained on behalf of a bankruptcy estate are generally entitled to be compensated under the same approaches as those representing a class consisting of other than bankruptcy creditors. See generally *In re Churchfield Management & Investment Corp.*, 98 B.R. 838, 853 (Bankr. N.D. Ill. 1989).

IV. CLASS ACTION CLAIMS SHOULD NOT BE USED FOR AN IMPROPER PURPOSE.

A. "Strike Suits" – Described by the Supreme Court as "people who might be interested in getting quick dollars by making charges without regard to their truth so as to coerce corporate managers to settle worthless claims in order to get rid of them." Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 371 (1966).

B. Justice Rehnquist's frequently quoted pronouncement concerning class action lawsuits in the securities context:

> [I]n the field of federal securities laws governing disclosure of information, even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit.
>
> * * *

> Congress itself recognized the potential for nuisance or "strike" suits in this type of litigation . . . .
>
> * * *
>
> The potential for possible abuse of the liberal discovery provisions of the Federal Rules of Civil Procedure may . . . exist in this type of case to a greater extent than they do in other litigation. The prospect of extensive deposition of the defendant's officers and associates and the concomitant opportunity for extensive discovery of business documents, is a common occurrence in this and similar types of litigation. To the extent that this process eventually produces relevant evidence which is useful in determining the merits of the claims asserted by the parties, it bears the imprimatur of those Rules and of the many cases liberally interpreting them. **But, to the extent that it permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost, rather than a benefit.**

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975) (emphasis added).

DELAWARE BANKRUPTCY INN OF COURT

APRIL 17, 2012 PUPILAGE PROGRAM:
CLASS ACTIONS AND BANKRUPTCY

Team Leaders: Rick Cobb and Jim Carignan

APPENDIX

Exhibit A – Materials from Subtopic I - Class Action Basics

Exhibit B – Materials from Subtopic II – Overlay of Bankruptcy Procedures on Class Actions

Exhibit C – Materials from Subtopic III – Ethical Considerations

EXHIBIT A

Subtopic I - Class Action Basics

*** Current through changes received April 5, 2012 ***

FEDERAL RULES OF CIVIL PROCEDURE
TITLE IV. PARTIES

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USCS Fed Rules Civ Proc R 23

Rule 23. Class Actions

(a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:
(1) the class is so numerous that joinder of all members is impracticable;
(2) there are questions of law or fact common to the class;
(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
(4) the representative parties will fairly and adequately protect the interests of the class.

(b) Types of Class Actions. A class action may be maintained if Rule 23(a) is satisfied and if:
(1) prosecuting separate actions by or against individual class members would create a risk of:
(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or
(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;
(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or
(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:
(A) the class members' interests in individually controlling the prosecution or defense of separate actions;
(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;
(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and
(D) the likely difficulties in managing a class action.

(c) Certification Order; Notice to Class Members; Judgment; Issues Classes; Subclasses.
(1) *Certification Order.*
(A) Time to Issue. At an early practicable time after a person sues or is sued as a class representative, the court must determine by order whether to certify the action as a class action.
(B) Defining the Class; Appointing Class Counsel. An order that certifies a class action must define the class and the class claims, issues, or defenses, and must appoint class counsel under Rule 23(g).
(C) Altering or Amending the Order. An order that grants or denies class certification may be altered or amended before final judgment.
(2) *Notice.*

(A) For (b)(1) or (b)(2) Classes. For any class certified under Rule 23(b)(1) or (b)(2), the court may direct appropriate notice to the class.

(B) For (b)(3) Classes. For any class certified under Rule 23(b)(3), the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must clearly and concisely state in plain, easily understood language:

(i) the nature of the action;

(ii) the definition of the class certified;

(iii) the class claims, issues, or defenses;

(iv) that a class member may enter an appearance through an attorney if the member so desires;

(v) that the court will exclude from the class any member who requests exclusion;

(vi) the time and manner for requesting exclusion; and

(vii) the binding effect of a class judgment on members under Rule 23(c)(3).

(3) *Judgment.* Whether or not favorable to the class, the judgment in a class action must:

(A) for any class certified under Rule 23(b)(1) or (b)(2), include and describe those whom the court finds to be class members; and

(B) for any class certified under Rule 23(b)(3), include and specify or describe those to whom the Rule 23(c)(2) notice was directed, who have not requested exclusion, and whom the court finds to be class members.

(4) *Particular Issues.* When appropriate, an action may be maintained as a class action with respect to particular issues.

(5) *Subclasses.* When appropriate, a class may be divided into subclasses that are each treated as a class under this rule.

(d) Conducting the Action.

(1) *In General.* In conducting an action under this rule, the court may issue orders that:

(A) determine the course of proceedings or prescribe measures to prevent undue repetition or complication in presenting evidence or argument;

(B) require--to protect class members and fairly conduct the action--giving appropriate notice to some or all class members of:

(i) any step in the action;

(ii) the proposed extent of the judgment; or

(iii) the members' opportunity to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or to otherwise come into the action;

(C) impose conditions on the representative parties or on intervenors;

(D) require that the pleadings be amended to eliminate allegations about representation of absent persons and that the action proceed accordingly; or

(E) deal with similar procedural matters.

(2) *Combining and Amending Orders.* An order under Rule 23(d)(1) may be altered or amended from time to time and may be combined with an order under Rule 16.

(e) Settlement, Voluntary Dismissal, or Compromise. The claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval. The following procedures apply to a proposed settlement, voluntary dismissal, or compromise:

(1) The court must direct notice in a reasonable manner to all class members who would be bound by the proposal.

(2) If the proposal would bind class members, the court may approve it only after a hearing and on finding that it is fair, reasonable, and adequate.

(3) The parties seeking approval must file a statement identifying any agreement made in connection with the proposal.

(4) If the class action was previously certified under Rule 23(b)(3), the court may refuse to approve a settlement unless it affords a new opportunity to request exclusion to individual class members who had an earlier opportunity to request exclusion but did not do so.

(5) Any class member may object to the proposal if it requires court approval under this subdivision (e); the objection may be withdrawn only with the court's approval.

(f) Appeals. A court of appeals may permit an appeal from an order granting or denying class-action certification under this rule if a petition for permission to appeal is filed with the circuit clerk within 14 days after the order is

entered. An appeal does not stay proceedings in the district court unless the district judge or the court of appeals so orders.

(g) Class Counsel.

(1) *Appointing Class Counsel.* Unless a statute provides otherwise, a court that certifies a class must appoint class counsel. In appointing class counsel, the court:

(A) must consider:

(i) the work counsel has done in identifying or investigating potential claims in the action;

(ii) counsel's experience in handling class actions, other complex litigation, and the types of claims asserted in the action;

(iii) counsel's knowledge of the applicable law; and

(iv) the resources that counsel will commit to representing the class;

(B) may consider any other matter pertinent to counsel's ability to fairly and adequately represent the interests of the class;

(C) may order potential class counsel to provide information on any subject pertinent to the appointment and to propose terms for attorney's fees and nontaxable costs;

(D) may include in the appointing order provisions about the award of attorney's fees or nontaxable costs under Rule 23(h); and

(E) may make further orders in connection with the appointment.

(2) *Standard for Appointing Class Counsel.* When one applicant seeks appointment as class counsel, the court may appoint that applicant only if the applicant is adequate under Rule 23(g)(1) and (4). If more than one adequate applicant seeks appointment, the court must appoint the applicant best able to represent the interests of the class.

(3) *Interim Counsel.* The court may designate interim counsel to act on behalf of a putative class before determining whether to certify the action as a class action.

(4) *Duty of Class Counsel.* Class counsel must fairly and adequately represent the interests of the class.

(h) Attorney's Fees and Nontaxable Costs. In a certified class action, the court may award reasonable attorney's fees and nontaxable costs that are authorized by law or by the parties' agreement. The following procedures apply:

(1) A claim for an award must be made by motion under Rule 54(d)(2), subject to the provisions of this subdivision (h), at a time the court sets. Notice of the motion must be served on all parties and, for motions by class counsel, directed to class members in a reasonable manner.

(2) A class member, or a party from whom payment is sought, may object to the motion.

(3) The court may hold a hearing and must find the facts and state its legal conclusions under Rule 52(a).

(4) The court may refer issues related to the amount of the award to a special master or a magistrate judge, as provided in Rule 54(d)(2)(D).

EXHIBIT B

Subtopic II – Overlay of Bankruptcy Procedures on Class Actions

What Happens When Class Actions Collide with Bankruptcy?

(Spring 2006, American Bar Association Journal)

Being a defendant in class action litigation is challenging or, at the very least, demanding. The adage suggests that misery loves company, and therefore having codefendants in such a case can be heartening. Indeed, a class action defendant can sometimes look to its codefendants for assistance. Codefendants may defray the costs, share the scrutiny and the work load, and help with legal strategy. They may present a unified front against the throng that comprises the class in a class action. But what happens when one of these codefendants declares bankruptcy?

Consider the following scenario. Companies A, B, and C are all in the business of manufacturing widgets. A class action has been filed against A, B, and C together. All three companies assert cross-claims against one another. Company B files for bankruptcy protection under Chapter 11, and all suits against it are stayed. How does this affect companies A and C? Will this hurt their defenses in the class action? What is the effect of the cross-claims? Can A and C do anything to protect themselves? Can they benefit from B's bankruptcy? How? Why should A and C have to litigate while all actions against B are stayed?

Several options are available to a class action defendant whose codefendant has declared bankruptcy. A codefendant may opt to remain in the original jurisdiction and move the case along without the debtor defendant. It may seek removal and transfer on the basis of "related to" jurisdiction in the bankruptcy court in which the case is filed. This article specifically discusses the benefits of seeking removal and/or transfer on the basis of "related to" bankruptcy jurisdiction as well as the hurdles such a defendant will have to overcome. It also touches on some arguments against opting for "related to" jurisdiction and how defending the action in its original jurisdiction may affect the remaining defendants.

Meeting the Legal Standards

A class action defendant whose codefendant has filed for bankruptcy protection may have the option of having the class action against it removed to federal court, if it is a state court action, and then transferred to the jurisdiction in which the bankruptcy proceedings are taking place. To obtain federal jurisdiction, a defendant is free to argue that the class action is "related to" the bankruptcy. This "related to" jurisdiction "is the broadest of the potential paths to bankruptcy jurisdiction."[1] However, the law surrounding this "related to" jurisdiction and the arguments supporting transfer from federal courts to the district where the bankruptcy is being adjudicated are complex. Removal or transfer of a lawsuit on the basis of "related to" jurisdiction is not easy to obtain for a class action codefendant, but tremendous benefits may be reaped by a codefendant if it is successful. Although removal and transfer require meeting separate statutory requirements, they often occur together.

Removal. To transfer a case to the bankruptcy court's jurisdiction, a federal district court has to have

control of the case. Because many class actions are filed in state court, the transfer to bankruptcy court is a multistep process. The first step in an attempt to consolidate all the claims into one bankruptcy court is removal of the cases to the federal district courts where the cases are located. Such removal is effectuated pursuant to 28 U.S.C. § 1452, which provides:

A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under Section 1334 of this title.

Section 1452 only permits removal when the court has jurisdiction under 28 U.S. § 1334, which states:

(a) Except as provided in subsection (b) of this section, the district court shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

To summarize, then, Section 1334 sets forth four possible grounds for jurisdiction in federal court. These district courts have jurisdiction when the proceedings are (1) "under" title 11, (2) "arising under" a title 11 case, (3) "arising in" a title 11 case, and (4) "related to" a title 11 case. Section 1334 provides an additional ground for a federal court to exercise jurisdiction, although it is not as commonly discussed as the traditional grounds of federal question and diversity jurisdiction

Cases "under" title 11, as referenced in Section 1334(a), are bankruptcy proceedings.[2] "Under" title 11 refers to the bankruptcy case itself and not to any other proceedings within the case. Claims against a class action codefendant would not qualify for bankruptcy court jurisdiction "under" title 11.[3] The "arising under" and "arising in" grounds of the jurisdiction granted by Section 1334 "involve core proceedings 'arising under' title 11 or 'arising in a case under' title 11. These are causes of action that are expressly created by title 11."[4]

The phrase "related to" is not defined in the Bankruptcy Code but has been interpreted broadly by most courts. Although the federal circuit courts do not agree on a single approach, the majority have determined that the test for determining if a proceeding is "related to" a bankruptcy is "whether *the outcome of the proceeding could conceivably have any effect on the estate being administered*." [5] "Related to" jurisdiction is thus the tool that may be used by defendants to consolidate their cases into a codefendant's bankruptcy.

Transfer. In class actions in federal court, a codefendant's first step is to transfer the case to the bankruptcy court. Defendants move for transfer of venue pursuant to 28 U.S.C. § 1404(a) in order to have the case moved to the bankruptcy court's district. Section 1404(a) provides that "[f]or the

convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought." The threshold question in a motion to transfer venue is whether the action might have been brought in the proposed transferee district. [6] Once it has been concluded that venue is proper in the transferee court, a district court has broad discretion to determine the forum by examining the convenience of the parties and witnesses and the interests of justice. [7] To answer the threshold question of whether the action could have been brought in the transferee court, a debtor's codefendant need only look to 28 U.S.C. § 1409(a). Pursuant to that section, a proceeding "arising in or related to a case under title 11 may be commenced in the district court in which such case is pending."

The *Pacor* standard and "related to" jurisdiction. The circuits are split about "related to" jurisdiction in tort cases. *Pacor v. Higgins* [8] is generally considered the seminal case on "related to" jurisdiction and articulates the standard that is applied in most circuits. Although *Pacor* was not a class action, the standard is generally the same. [9] *Pacor* arose out of the Johns-Manville bankruptcy. The defendant, Pacor, a chemical distribution company, attempted to have its cases transferred to the Southern District of New York, where the Manville bankruptcy was being adjudicated.

The plaintiff, John Higgins, was an employee of Pacor. He brought a products liability action in Pennsylvania state court against Pacor, alleging exposure to asbestos. Pacor brought a third-party action against Manville, alleging that Manville was the original manufacturer of the asbestos. After Manville filed for bankruptcy in the Southern District of New York, Pacor's action against Manville was severed from the underlying action. Pacor then sought to have the Higgins action removed to federal court and transferred to the Southern District of New York to be adjudicated with the Manville bankruptcy. The court denied "related to" jurisdiction to Pacor and transferred the case back to the state court from which it had originated.

Although the *Pacor* court recognized that "the proceeding need not necessarily be against the debtor or against the debtor's property," it determined that Higgins's claims were not related to the Manville bankruptcy. [10] The court determined that "[a]n action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." [11]

Despite its articulation of this seemingly broad test, the *Pacor* court nonetheless found that Higgins's claims were not related to the bankruptcy, stating "the primary action between Higgins and Pacor would have no effect on the Manville bankruptcy estate."[12] The court reasoned that even if Higgins prevailed, Manville would be able to relitigate issues or adopt any position in response to a claim against it by Pacor. Because "any judgment received by the plaintiff Higgins could not itself result in even a contingent claim against Manville,"[13] a judgment for the plaintiff against Pacor would not affect the estate. Following *Pacor*, courts have interpreted the test as inquiring "whether the allegedly related lawsuit would affect the bankruptcy proceeding without the intervention of yet another lawsuit."[14]

The standard in *Pacor* has been widely adopted.[15] In fact, the U.S. Supreme Court recognized this test

and agreed that "related to" jurisdiction is "a grant of some breadth."[16] The Court did state that there were some limits to "related to" jurisdiction but did not state what those limits should be.

Other "related to" standards. Those circuits that have not adopted *Pacor* have a variety of similar tests. The Second and Seventh Circuit Courts of Appeal have adopted narrower tests than that described in *Pacor,* while the Fourth and Sixth Circuit Courts of Appeal have adopted broader ones.

The Second Circuit's "significant connection" test was adopted in *In re Turner*. [17] The *Turner* court found that because there was no showing of a "significant connection with [the] bankruptcy case . . . it therefore [fell] outside the scope of § 1471(b), which allow[ed] the district courts to conduct civil proceedings 'related to' cases under Title 11."[18] This "significant connection" test is narrower than the "in any way impacts" language found in *Pacor*. The Seventh Circuit took a somewhat different approach, cautioning against a broad reading of the "related to" language "in a universe where everything is related to everything else."[19] In *In re Dow Corning Corp.,* [20] the Sixth Circuit determined that the bankruptcy court had "related to" jurisdiction over potential claims arising from indemnification or contribution claims between nondebtors and the debtor. The *Dow Corning* court brought all of the silicon gel breast implant injury cases into one court, the bankruptcy court presiding over Dow Corning's Chapter 11 case. The *Dow Corning* court noted that the nondebtor defendants either had filed, or could file, claims for indemnification or contribution against the debtor. The court distinguished *Pacor* because it was a single-plaintiff action that could not feasibly have had such a massive effect on the estate. The *Dow Corning* court found that "[a] single possible claim for indemnification or contribution simply does not represent the same kind of threat to a debtor's reorganization plan as that posed by the thousands of potential indemnification claims at issue here."[21] In dismissing the plaintiffs' *Pacor*-type argument that "related to" jurisdiction could not exist until a judgment was entered against any defendant, thereby giving rise to an indemnification or contribution claim, the court held "[c]ertainty, or even likelihood, is not a requirement. Bankruptcy jurisdiction will exist so long as it is possible that a proceeding may impact on 'the debtor's rights, liabilities, options, or freedom of action' or the 'handling and administration of the bankrupt estate.'"[22]

Similarly, in *A.H. Robins Co., Inc. v. Piccinin*, [23] the Fourth Circuit adopted an expansive reading of "related to." Robins's bankruptcy filing was precipitated by an "avalanche of actions" against Robins (a manufacturer of the Dalkon Shield), its insurers and its officers and directors. The *Robins* court quoted the *Pacor* standard but then transferred all actions against Robins and the nondebtor codefendants to the U.S. District Court for the Eastern District of Virginia, where Robins's bankruptcy had been filed.

A codefendant seeking a finding that the bankruptcy court has "related to" jurisdiction can argue that the class action has the potential to affect the bankruptcy, and the estate, in a multitude of ways and thus is clearly related to the bankruptcy case. First, a defendant can argue that the action arises out of the same underlying facts as the claims against the debtor and undoubtedly will become the subject of proofs of claim filed in the bankruptcy case. Second, a defendant can argue about the potential for cross-claims for indemnity or contribution (or that such cross-claims already exist) that would affect the administration of the bankrupt's estate. One distinction that has been made within the boundaries of

Pacor is where there is a preexisting contractual right to indemnification between the debtor and its codefendants.[24] Third, if the class plaintiffs are alleging that the defendants and the debtor were partners or shared a community of interests, the defendants can argue that the amount of class action plaintiffs' claims against the debtor may be reduced by the amount the plaintiffs recover against the defendants, and vice versa.[25] In a class action, a debtor's codefendant has a strong "interest of justice" argument in favor of transfer. A codefendant can argue that only a transfer, and one consolidated action, would foster a prompt, fair, and complete resolution of the class action. As such, such a transfer would promote judicial efficiency and avoid conflicting results.

Mandatory or discretionary abstention. A defendant seeking removal and transfer on the basis of "related to" jurisdiction cannot breathe easy after the case has been removed and transferred to the bankruptcy court. One more hurdle must be surmounted before the case can be adjudicated in the bankruptcy court. The defendant must still overcome the potential for mandatory and discretionary abstention by the transferee court to have its case litigated in the bankruptcy court.

Under Section 1334(c)(2), [26] a court is required to abstain from hearing an action when six elements are present: (1) a party files a timely motion, (2) the proceeding is based on a state law claim or cause of action, (3) the matter is "related to" a case under chapter 11 (and is not a proceeding "arising under" title 11 or "arising in" a case under title 11), (4) the action could not have been commenced in federal court absent bankruptcy, (5) a state court action has been commenced, and (6) the state court action can be timely adjudicated.[27] The mandatory abstention doctrine does not impact codefendants in federal cases because elements 5 and 6 would not be fulfilled. A class of plaintiffs seeking to avoid having all claims transferred and adjudicated with the bankruptcy should timely file a motion pursuant to Section 1334(c)(2) requesting that the court abstain from hearing the case and requesting remand.[28]

Section 1334(c)(1) [29] provides for discretionary abstention when principles of fairness, comity, and integrity of the bankruptcy process call for it.[30] As noted in a recent case, "[t]hrough § 1334(c)(1), Congress intended that concerns of judicial convenience and comity should be met by the discretionary exercise of abstention when appropriate, not by rigid limitations on federal jurisdiction."[31]

A codefendant can argue that a court should not abstain because centralizing the resolution of all issues involved in the case with those of the estate of the debtor will promote comity.[32] A codefendant can further argue that the entire class action will be most expeditiously and fairly resolved in the jurisdiction where the debtor's bankruptcy is pending. Only the bankruptcy court can consider the extent to which discovery can be conducted against the debtor, and the extent to which any action against the debtor should be permitted to proceed. The bankruptcy court will be able to structure a process that will promote all parties' interests in a timely adjudication of the issues and will be able to provide a debtor with the protection against the onslaught of conflicting litigation demands that it sought when it filed its Chapter 11. A codefendant can posit that the bankruptcy court should have control over not only of those claims against the debtor but all claims that are inextricably entwined with them. Only by giving the bankruptcy court the overall control over all claims in the related actions is the timely adjudication

of these claims possible. Otherwise, class action plaintiffs and codefendants alike would be required to proceed simultaneously in multiple forums to obtain critical discovery from the debtor. This would waste the parties' resources. As such, a codefendant can argue that multiple factors weigh against a court abstaining from exercising jurisdiction over the related actions.

Deciding Whether to Seek Removal and Transfer

Benefits of the bankruptcy court. Although "related to" jurisdiction and a transfer to bankruptcy court may be difficult to obtain, defendants do so because of the many potential benefits to them if they succeed. A defendant who has been named in state court class actions all over the country may want to use "related to" jurisdiction as a means of consolidating all the cases against it in one federal court. Transferring all the cases pending against the nondebtor codefendants to the district where the debtor's bankruptcy is pending blocks trial dates in all transferor courts. In assessing the relative benefits of transferring cases to the debtor's bankruptcy court, some defendants may view transfer as a quick means by which to delay all litigation in all courts at once. Moreover, by transferring the cases, the nondebtor codefendant can force the class action plaintiffs to litigate in a foreign forum, where they may lose their "home court" advantage. And, of course, the parties can realize economies of scale and potentially massive transaction costs by litigating all the cases in the same jurisdiction. "Related to" jurisdiction is an efficient means for the court to manage all the claims and promote judicial economy.

It has been argued that permitting consolidation of actions on the basis of "related to" jurisdiction allows deep pocket defendants to set the pace of litigation. It alleviates pressure to settle on plaintiffs' terms because codefendants no longer have to defend multiple actions in multiple courts, giving them more control of their own destiny and loosening the litigation noose. The transfer also provides disincentives to early settlement by suspending trial dates and lessening all pressure of deadlines.

The decision to seek removal and transfer of a case on the basis of "related to" jurisdiction should be made based on the specific facts of a defendant's own circumstances. It may be easier for a codefendant in a class action to seek "related to" jurisdiction because class claims (and any indemnification or contribution claims arising from them) have the potential to have far greater effects on the debtor's estate than individual claims.[33]

It is much easier for a codefendant in a federal class action to have its claims transferred to the district where the bankruptcy is pending because no federal jurisdictional hurdle need be overcome. A state court codefendant must go through a multistep process as its case must be removed and transferred. The time and cost associated with such legal maneuvers should be considered before the decision to remove and transfer is made.

Pitfalls of the bankruptcy court. Despite all the potential benefits, some potentially negative aspects may arise when moving all the cases to the bankruptcy jurisdiction. The new forum may not be friendly to the nondebtor codefendant. After all, the codefendant is walking into the debtor's backyard and appearing before the court that is charged with administering the estate of the debtor. These courts are

not always friendly to interloping codefendants, especially where their intentions may be at odds with the health of the estate.

A nondebtor codefendant may prefer to be in a position to manage the litigation on its own and to point the finger at the now absentee debtor. A defendant who defends the case in its original jurisdiction suddenly has an easy scapegoat in the absentee debtor. A transfer to the bankruptcy jurisdiction prevents such a codefendant from participating in such finger-pointing. Furthermore, a debtor may contest "related to" jurisdiction because it does not want a class action to complicate the management of its bankruptcy estate and its potential emergence from bankruptcy.

Transferring cases on the basis of "related to" jurisdiction may mean that the nondebtor codefendant then has to contend with a strong and well-organized creditors' committee fighting over the estate. Furthermore, such a "related to" transfer may impact whether a jury trial is available. Attorneys representing codefendants must consider these potentially negative impacts of "related to" jurisdiction before the strategic decision to seek that jurisdiction is made.

Conclusion

Although it may be challenging to remove and transfer cases to a codefendant's bankruptcy court on the basis of "related to" jurisdiction, there are many potential benefits to class action codefendants that are able to do so. We have had experience with this very issue in a series of class actions that were filed in courts around the country. In undertaking an evaluation of the factors discussed throughout this article, one thing became crystal clear to us: a defendant faced with the possibility of removing and transferring cases based on "related to" jurisdiction must employ a rigorous analysis of the pros and cons of doing so. Indeed, under the right circumstances, the benefits of a successful removal and transfer tactic can be huge to a defendant. Even if the strategy is not completely implemented, the filing of he relevant papers and the favorable rulings of a few judges on the removal briefs would likely alter the plaintiffs' views of the prosecution of the case. No longer would the plaintiffs hold the upper hand, forcing the defendants to litigate in the plaintiffs' choice of forum. The playing field would be leveled to some extent. In sum, counsel would be remiss not to at least consider the tactical benefits that may result from developing a strategy of consolidation.

* * *

1. *In re* Resorts Int'l., Inc., 372 F.3d 154, 163 (3d Cir. 2004).

2. *In re* Wood, 825 F.2d 90, 92 (5th Cir. 1987).

3. *See, e.g., In re* Fulfer, 159 B.R. 921, 923 (Bankr. D. Idaho. 1993) (finding that a case was not arising under Title 11 "because the action is neither 'created [n]or determined by a statutory provision of title 11'").

4. Williams v. Shell Oil Co., 169 B.R. 684, 688 (S.D. Cal. 1994); *In re* S & M Constructors, Inc., 144 B.R. 855, 859 (Bankr. W.D. Mo. 1992).

5. Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984), *overruled on other grounds by* Things Remembered, Inc. v. Petrarca, 516 U.S. 124, 134 - 35 (1995).

6. Pope v. Mo. Pac. R. Co., 446 F. Supp. 447, 449 (W.D. Okla. 1978), *superseded on other grounds by* 28 U.S.C. § 1391 *as amended*.

7. Sky Tech. Partners v. Midwest Research Inst.., 125 F. Supp. 2d 286, 291 (S.D. Ohio 2000).

8. 743 F.2d 984 (3d Cir. 1984), *overruled on other grounds by* Things Remembered, Inc. v. Petrarca, 516 U.S. 124 (1995).

9. In some circuits, it may be easier for a class action codefendant to obtain "related to" jurisdiction than for an individual action defendant to do the same because of the impact a class action will have on the estate.

10. 743 F.2d at 994.

11. *Id.*

12. *Id.* at 995.

13. *Id.*

14. *In re* Federal-Mogul Global, Inc., 300 F.3d 368, 382 (3d Cir. 2002).

15. *See, e.g., In* re G.S.F. Corp., 938 F.2d 1467, 1475 (1st Cir. 1991), *abrogated on other grounds by* 503 U.S. 249; *In re* Wood, 825 F.2d 90, 93 (5th Cir. 1987); *In re* Dogpatch U.S.A., Inc., 810 F.2d

782, 786 (8th Cir. 1987); *In re* Am. Hardwoods, Inc., 885 F.2d 621, 623 (9th Cir. 1989).

16. Celotex Corp. v. Edwards, 514 U.S. 300, 308 (1995).

17. 724 F.2d 338 (2d. Cir. 1983).

18. *Id.* at 341; *see also In re* Lencoke Trucking, Inc., 99 B.R. 200, 201 (W.D.N.Y. 1998) (a "case is 'related' to a Title 11 case if there is a 'significant connection' or nexus between the case at issue and the bankruptcy proceeding"); *In re* Holland Indus., Inc., 103 B.R. 461, 468 (Bankr. S.D.N.Y. 1989) ("*Turner* requires the litigation to have a 'significant connection with bankruptcy.'").

19. *In re* Fedpak Sys., Inc., 80 F.3d 207, 214 (7th Cir. 1996). *See also In re* Xonics, Inc., 813 F.2d 127 (7th Cir. 1987).

20. 86 F.3d 482 (6th Cir. 1996).

21. *Id.* at 494.

22. *Id* at 491. Although the *Dow Corning* court's test for "related to" jurisdiction is seemingly broader than the Third Circuit's *Pacor* test, the Third Circuit did not reject *Dow Corning* outright when it considered the issue in *In re Combustion Engineering*, 391 F.3d 190, 231 (3d Cir. 2004). Rather, in *Combustion Engineering*, the Third Circuit chose to distinguish *Dow Corning* rather than reject it as contrary to *Pacor*.

23. 788 F.2d 994 (4th Cir. 1986).

24. *See, e.g.,* Gem Commercial Assocs. v. TJX Companies, Inc., 2003 WL 21488304 (D. Conn. June 26 2003).

25. *See In re* Showcase Natural Casing Co., Inc., 54 B.R. 142, 144 (Bankr. S.D. Ohio 1985) (finding "related to" jurisdiction when a holding of liability against defendants would necessarily reduce plaintiff's recovery against debtor and vice versa).

26. This section provides: "Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been

commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction."

27. *In re* Nationwide Roofing & Sheet Metal, Inc., 130 B.R. 768, 778 (Bankr. S.D. Ohio 1991).

28. Personal injury tort cases and wrongful death cases are not subject to mandatory abstention under Section 1334(c)(2). "[P]ersonal injury cases are not subject to this mandatory abstention provision. 28 U.S.C. §§ 157(b)(2) and (4), defining the so-called core proceedings, which may be heard by bankruptcy judges, say that although 'personal injury tort' and 'wrongful death' claims are 'non-core' proceedings outside the jurisdiction of bankruptcy judges, such cases 'shall not be subject to the mandatory abstention provisions of section 1334(c)(2).'" *In re* White Motor Credit, 761 F.2d 270, 272 (6th Cir. 1985).

29. This section states: "Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11."

30. *In re* Federal-Mogul Global, Inc., 300 F.3d 368, 376 (3d Cir. 2002).

31. Austin v. Provident Bank, 2005 WL 1785285, at *4 (N.D. Miss. July 26 2005).

32. *See* Carver v. Knox County, Tenn., 887 F.2d 1287, 1289 - 93 (6th Cir. 1989).

33. *Compare In re* Dow Corning, 86 F.3d 482 (6th Cir. 1996) (class action), *and* Pacor v. Higgins, 743 F.2d 984 (3d Cir. 1984) (individual action).

Hot Bankruptcy Topics in the Fifth Circuit: The Rise of Class Actions, the Fall of Gift Plans and That Equitable Mootness Doctrine

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I. INTRODUCTION

The Fifth Circuit has been active in bankruptcy appeals over the past year. Among its many recent decisions, the court of appeals recently held that a bankruptcy court has the jurisdiction and the authority to certify a class of debtors under the right circumstances. The court of appeals has also continued to explain the applicability (and non-applicability) of the equitable mootness doctrine. But perhaps the biggest recent news in circuit court decisions came from the Second Circuit in the *DBSD North America* decision.[1] In that appeal, the Second Circuit held that a "gift" from one senior class to another junior class through a chapter 11 plan violated the absolute priority rule under chapter 11's "fair and equitable" cram down standards.

This paper will begin by discussing the *DBSD* decision, its analysis of the "gifting doctrine," and the potential ramifications to chapter 11 plans in Fifth Circuit bankruptcy cases. Next, this paper will discuss the viability of class actions in bankruptcy courts, which is of particular relevance in light of the Fifth Circuit's recent *Wilborn*[2] decision and other ongoing issues with the Mortgage Electronic Registration System ("MERS"). Finally, because the issue seems to appear in several recent Fifth Circuit decisions, this paper will discuss the Fifth Circuit's recent applications and discussions of the equitable mootness doctrine.

II. IS THE GIFTING DOCTRINE DEAD FOR CHAPTER 11 PLANS?

Perhaps one of the most useful and powerful tools for negotiating a chapter 11 plan is a "gift" arrangement.[3] In a typical "gifting" scenario, a senior class of creditors (usually an under-secured class) "gives" part of its recover to a junior class of claimants or interest holders as part of a plan. The primary argument for those supporting the concept is that "giving" creditors should be free to allocate its collateral to junior claim holders as part of a settlement under a plan, and that there is nothing unfair or inequitable about such allocations, though some creditors may be left out. Those opposing this concept, however, argue that "free allocation" is another way to skirt the absolute priority rule, because the classes skipped over have not been paid in full or consented to the proposed plan treatment.

What we now call the absolute priority rule is a codification of pre-Bankruptcy Code rules designed to counteract the dangers associated with the inherent bargaining power held by a debtor's current management and ownership in negotiating a plan of reorganization.[4] Such restrictions were codified in section 1129(b)(2)(B) of the Bankruptcy Code and prohibit junior classes from receiving "any property" "under the plan" "on account of such junior claim" unless higher priority claims are paid in full or the intervening classes consent.

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[1] *See DISH Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, --- F.3d ----, 2011 WL 350480, 2010 US App. LEXIS 27007 (2d Cir. Feb. 7, 2011) (pagination unavailable).

[2] *See generally In re Wilborn v. Wells Fargo Bank, N.A. (In re Wilborn)*, 609 F.3d 748 (5th Cir. 2010).

[3] *See* Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach*, 29 Am. Bankr. Inst. J. 50, 50 (Sept. 2010).

[4] *See generally Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 444-45, 119 S. Ct. 1411, 1417-18; 143 L. Ed. 2d 607 (1999) (citations omitted) ("The reason for such a limitation was the danger inherent in any reorganization plan proposed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor's owners.").

A. Introduction to the *DBSD* Decision

In February 2011, the Second Circuit was faced with a plan where the undersecured junior lien holders attempted to "gift" some of the new equity they were entitled to receive to old equity.[5] The Second Circuit rejected the "gift" characterization and found, instead, that the plan gave the equity class property on account of its old equity interests, but did not pay unsecured claims in full. This, held the court, violated the absolute priority rule and required reversal.

To reach this conclusion, the analysis was straight-forward. The court considered the following elements: (i) did the equity holders receive property; (ii) was the property distributed under the plan; and (iii) was the property distributed "on account of" the existing equity or some new value? First, relying upon *Ahlers*, the court of appeals found that the shares and warrants given to old equity under the plan fell within the broad definition of "any property."[6] Second, the court had no question that the shares and warrants were being distributed "under the plan." Third, relying on *203 N. LaSalle,* the court of appeals found that the shares and warrants were distributed to old equity holders "because of" or "on account of" the existing equity interests in the debtor.[7]

The Second Circuit reasoned that *Ahlers* and *203 N. LaSalle* demonstrated the Supreme Court's strict application of the absolute priority rule.[8] What made this case an easier call was that old equity offered nothing that could be considered "new value" in exchange for the property received under the plan. The only thing that old equity seemed to offer in exchange for the shares and warrants to be distributed under the plan—aside from its old equity—was its "continued support and assistance" of the reorganized debtor. But the Supreme Court expressly rejected sweat equity as "new value" in *203 N. LaSalle.* Without any potential "new value," the Second Circuit had only to address whether the share and warrants could be considered a "gift" from a senior class of creditors, as the bankruptcy court did. Implicit in this argument was the belief that the "gifting" mechanism excused the distributions from the absolute priority rule, because the equity class would not be receiving the debtor's property under the plan. To decide that issue, the court of appeals was required to decide whether *SPM*'s "gifting doctrine" had any application to chapter 11 cases.

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[5] *In re DBSD N. Am., Inc., supra* note 1. The plan proposed to pay unsecured claims a dividend in the range of 4% to 46%, and allow existing equity to receive shares and warrants in the reorganized debtor in exchange for old equity's support of the plan and "continued cooperation and assistance" in the reorganized debtor. Notably, the "gifting" mechanism was not explicit from the plan; the bankruptcy court characterized the extensions of shares and warrants as a "gift" from the junior lien holders and confirmed the plan. The district court affirmed.

[6] *See id.* at 25 (citing *Northwest Bank Worthington v. Ahlers*, 485 U.S. 197, 208, 108 S. Ct. 963, 969, 99 L. Ed. 2d 169 (1988)).

[7] *See id.* at 26 (citing *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship,* 526 U.S. 434, 449, 119 S. Ct. 1411; 143 L. Ed. 2d 607 (1999)) ("Even under this general test, the existing shareholder here receives property 'on account of' its prior junior interest because it receives new shares and warrants at least partially 'in exchange for' its old ones.").

[8] *See id.* at 29-30.

B. *SPM, MCorp* and *Genesis Health*

Before discussing the Second Circuit's answer, it is important to understand the doctrine. While not necessarily originating from the First Circuit, the concept of "gifting" was most famously endorsed by the First Circuit in *In re SPM Manufacturing Corp.*[9] In that case, during the course of the chapter 11 case, the senior secured lenders reached an agreement with the creditors' committee under which the lenders would share some of their rights to the debtor's proceeds in exchange for the committee's cooperation during the case. When the case converted to chapter 7 and the trustee began making distributions pursuant to the compromise approved by the court during the chapter 11, certain tax priority creditors objected, arguing that the distributions to unsecured creditors before payment of priority claims violated the scheme required under section 726 of the Bankruptcy Code. The First Circuit ultimately rejected the tax claimants' arguments:

> The Code does not govern the rights of creditors to transfer or receive nonestate property. While the debtor and the trustee are not allowed to pay nonpriority creditors ahead of priority creditors, []creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors.[10]

Since the First Circuit issued the *SPM* decision in 1993, courts have divided on its application to chapter 11 cases. For example, even before the *DBSD* decision, the Second Circuit explained in 2007 *Iridium Operating* that "*SPM* stands for the proposition that in a Chapter 7 liquidation proceeding, an under-secured lender with a conclusively determined and uncontested 'perfected, first security interest' in all of a debtor's assets may, through a settlement, 'share' or 'gift' some of those proceeds to a junior, unsecured creditor, even though a priority creditor will go unpaid."[11]

On the other hand, following the issuance of the *SPM* decision, the U.S. District Court for the Southern District of Texas immediately applied the *SPM* "gifting doctrine" to a chapter 11 plan settlement in *MCorp*.[12] In that case, the Judge Lynn Hughes confirmed a liquidating chapter 11 plan over the objections of an intervening class of bond holders. The *MCorp* plan included a global settlement among the senior secured lenders and the FDIC. Judge Hughes held that the plan could be confirmed over the objections of several junior bond holders (with arguably superior claims). The junior bond holders argued that their claims had a higher priority than the FDIC's unsecured claims and that, because the secured bond claims were not being paid in full, the plan could not allow any distributions to bypass them and go the FDIC.[13] The court declined to address the relative priority between the bond claimants and the FDIC's general unsecured claims because, for purposes of the present dispute, the court found the only salient

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[9] 984 F.2d 1305 (1st Cir. 1993).
[10] *Id.* at 1313 (citing *King v. United States*, 379 U.S. 329, 13 L. Ed. 2d 315, 85 S. Ct. 427 (1964)).
[11] *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 459 (2d Cir. 2007). The *Iridium Operating* decision is discussed *infra*.
[12] *See generally In re MCorp. Fin. Inc.*, 160 B.R. 941 (S.D. Tex. 1993).
[13] *See id.* at 690.

point to be the relative priority between the settling senior lien holders (the "seniors") and the objecting bond holders (the "juniors"):

> The seniors [m]ay share their proceeds with creditors junior to the juniors, as long as the juniors continue to receive a[t] least as much as what they would without the sharing. For instance, a secured creditor could share its proceeds with unsecured creditors whose priority came behind that of the IRS. [citing *SPM*] That the creditor was secured is not relevant; it was the creditor's status as prior to the IRS that allowed it to share with those under the IRS, just as the seniors' priority over the juniors allows them to fund the FDIC settlement. . . . The seniors are senior because the juniors agreed to be junior. No manipulation of corporate shells, no gerrymandering of classes, created the position of the juniors as next to last in line for assets. The impaired class does not like the consequence of its having agreed to be the penultimate recipient of asset distributions, but the class is being treated by the plan in a fashion consistent with all other classes, with their contract, and with the law. The subordinated bonds will be paid the assets that exceed the claims prior to theirs, and they will be paid their claims before equity is paid. All equity is treated alike. The plans survive under the statutory test.[14]

Nearly a decade later, a district court in Delaware applied the *SPM* "gifting doctrine" in *Genesis Health Ventures*, by confirming a chapter 11 plan of reorganization over the objections of certain unsecured creditors.[15] In that case, the court held that senior secured lenders were "free to allocate" proceeds as it desired without violating the absolute priority rule.[16]

C. *Armstrong World, OCA* and *Iridium Operating*

It would not be until 2005 that a circuit court would consider how the absolute priority rule affected the viability of plan gifting. In December 2005, the Third Circuit considered and rejected the "gifting doctrine" as applied to chapter 11 plans, concluding that the use of the doctrine ran afoul of the absolute priority rule.[17]

The plan in *Armstrong World* included 12 classes, though only three were relevant to the appeal.[18] Class 6 comprised the general unsecured non-priority claims. Class 7 comprised present and future unliquidated asbestos litigation-related claims. Class 12 comprised all holders

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[14] *Id.*

[15] *See generally In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 601-02 (D. Del. 2001) (relying on *MCorp* and *SPM* in confirming a plan which allowed the senior lenders to decide which classes could share in the lenders' share of distributions).

[16] *See id.* at 617-18 ("The Senior Lenders are *free to allocate* such value without violating the 'fair and equitable' requirement.") (emphasis added).

[17] *See generally In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir 2005).

[18] *See id.* at 509.

of equity interests in the debtor. The plan proposed to: (i) pay Class 6 claims 59.5% of their claims, (ii) fund $1.8 billion into a trust for the benefit of Class 7 claimants, and (iii) issue warrants in the reorganized debtor to Class 12 equity holders. The plan also provided that, should Class 6 claimants reject the plan, the warrants would be issued to Class 7 claimants (who held claims of equal priority to Class 6 claimants), but then Class 7 claimants would "automatically" waive their rights to the warrants and allow the warrants to be issued to Class 12 equity holders.[19]

While the *Armstrong World* plan was negotiated among the holders of Class 6, 7 and 12 claims and interests, the plan was ultimately rejected by Class 6 claim holders. Under the terms of the plan, Class 6's rejection caused the warrants to flow through Class 7—which voted to accept the plan—via "automatic waivers" to allow the warrants to be distributed to Class 12 equity holders. The net effect was the equity holders received the warrants in the reorganized debtor, but Class 6 unsecured creditors, which were not paid in full, were now a dissenting class. In its objection, the unsecured creditors committee argued that the plan's automatic gifting mechanism violated the absolute priority rule. The bankruptcy court disagreed and recommended confirmation, but the district court sustained the committee's objection and denied confirmation.[20] Appeal was taken to the Third Circuit.

Before the Third Circuit, the debtor first argued that there was no dissenting intervening class, because the new equity was flowing *through* Class 7, not *over* Class 6.[21] While noting that six does precede seven in a linear count, the court of appeals found that Class 6 and Class 7 claims were of the same priority. The court further concluded that there was nothing in the plain language of the statute or its legislative history that would require an "intervening" class for the absolute priority rule to be violated.[22] Because Class 6 and Class 7 were equal, and Class 6 was not consenting, the court agreed that the absolute priority rule had been implicated.

Second, the debtor argued that the court should follow the "*MCorp-Genesis*" rule and allow the Class 7 claimants to decide who may receive their property.[23] The Third Circuit, however, rejected the so-called *MCorp-Genesis* rule and concluded that *SPM*, *MCorp* and *Genesis Health* were each distinguishable and inapplicable.[24] Said the court, illustrating why the "gifting" mechanism proposed in the *Armstrong* plan violated the absolute priority rule:

> [T]he structure of the Plan makes plain that the transfer between Class 7 and Class 12 was devised to ensure that Class 12 received the warrants, with or without Class 6's consent. The distribution of

[19] *Id.*
[20] *See id.* at 510-11 (citing *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D. Del. 2005)).
[21] *Id.* at 513.
[22] *Id.* ("Under this reading, the statue would be violated because the Plan would give property to Class 12, which has claims junior to Class 6.").
[23] *See In re Armstrong World Indus., Inc.*, 432 F.3d at 513-14.
[24] *See id.* at 514 ("We adopt the District Court's reading of these cases, and agree that *they do not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive*. Creditors must also be guided by the statutory prohibition of the absolute priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B).") (emphasis added).

> the warrants was only made to Class 7 if Class 6 rejected the Plan. In turn, Class 7 automatically waived the warrants in favor of Class 12, without any means for dissenting members of Class 7 to protest. Allowing this particular type of transfer would encourage parties to impermissibly sidestep the carefully crafted strictures of the Bankruptcy Code, and would undermine Congress's intention to give unsecured creditors bargaining power in this context.[25]

The Third Circuit made clear that the warrants were being paid to the Class 12 equity holders "on account of" their existing equity, and that because such distributions were barred by the absolute priority rule, the plan could not be confirmed.

(1) The *OCA Inc.* Decision

To date, the only published opinion from a bankruptcy court in the Fifth Circuit to address the absolute priority rule as applied to gifting plans has agreed with *Armstrong World.*[26] In *OCA*, the secured lenders agreed to allow existing equity holders to participate in stock offerings and acquire equity in the reorganized debtor in exchange for their support of the plan. The court refused to confirm the plan, finding it violated the absolute priority rule.

In denying confirmation, the *OCA* court first distinguished *SPM*, noting that the distributions in *SPM* did not implicate the absolute priority rule, because that was a chapter 7 case.[27] Second, the court found the "settlement" approved in the *MCorp* case to be distinguishable because that settlement resolved *actual* litigation, whereas the ostensible settlement in *OCA* merely ensured existing equity's support of the plan.[28] The court in *OCA* was persuaded by the Third Circuit's decision in *Armstrong World.*[29] The *OCA* court further acknowledged that there were mechanisms and standards to address settlements through a plan, but concluded that the "settlement" proposed in this plan did not satisfy such standards.[30] Because the deal structure proposed in the *OCA* plan was a blatant violation of the absolute priority rule, the court denied confirmation.

(2) *Iridium Operating*

In 2007, the Second Circuit discussed the validity of gifting in *Iridium Operating, LLC,*[31] although outside the context of a plan. In that chapter 11 case, the creditors' committee and senior secured lenders reached a settlement under which the committee agreed not to challenge the lenders' liens in exchange for a cash distribution of the lenders' cash collateral. This distribution was sufficient to fund litigation against Motorola, the debtors' former parent. Motorola, who held administrative claims against the debtors, objected to the settlement and

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[25] *Id.* at 514-15.

[26] *See generally In re OCA, Inc.*, 357 B.R. 72 (Bankr. E.D. La. 2006) (ultimately concluding that gifting through a plan violates the absolute priority rule).

[27] *See id.*at 85.

[28] *See id.* Further, the *MCorp* court side-stepped the absolute priority rule by declining to decide whether the FDIC's claim was superior to the junior bond holders' claims.

[29] *See id.* at 87-88 (quoting *Armstrong World Industries,* 432 F.3d 507, 513 (3d Cir. 2005)).

[30] *In re OCA, Inc.*, 357 B.R. at 88-89.

[31] *See generally In re Iridium Operating, LLC,* 478 F.3d at 459-60.

argued that the lenders' cash gifts were effectively distributions to unsecured creditors without first paying priority claims in full, in violation of the absolute priority rule. The Second Circuit noted the distinctions between this case and *SPM*, and went so far as to question *SPM*'s applicability in chapter 11 cases, but declined to go further.[32]

Instead, the court focused on whether the absolute priority rule applies to pre-plan settlements, noting that the Fifth Circuit had rigidly applied the rule in rejecting a pre-plan settlement in *AWECO*.[33] "The Fifth Circuit accurately captures the potential problem a pre-plan settlement can present for the rule of priority, but, in our view, employs too rigid a test."[34] Instead of employing a *per se* rule, as the Fifth Circuit apparently did in *AWECO*, the Second Circuit opted to make the consideration of the absolute priority rule just another factor in the 9019 analysis.[35] The case was remanded for the bankruptcy court to conduct its analysis with this additional factor in mind.

(3) The Fifth Circuit's Application of the Absolute Priority Rule in *AWECO*

The Second Circuit's discussion of *AWECO* warrants further review. As noted above, the Second Circuit viewed the *AWECO* decision as a "rigid" application of the absolute priority rule to a pre-plan settlement.[36]

In *AWECO*, the chapter 11 debtor proposed to settle an unliquidated, unsecured non-priority claim asserted for $27 million by paying the claimant $5.3 million in cash and other property.[37] The IRS (a priority claimant), a judgment lien holder and other unsecured creditors objected to the settlement, arguing that the settlement depleted the estate of too much value, and left the estate with too little value to satisfy the secured and priority claims in full. The bankruptcy court held evidentiary hearings and, despite much conflicting evidence, found that the settlement was fair and equitable because it left sufficient assets to satisfy the objecting parties' claims.[38]

On appeal, the objecting claimants again urged that the settlement was not "fair and equitable" because it allowed assets to be distributed to a general unsecured creditor without a sufficient record to conclude that the debtor could still satisfy all claims with higher priorities.[39] The debtor responded that the Bankruptcy Code did not require a bankruptcy court to consider whether a pre-plan settlement satisfies the absolute priority rule, so long as the settlement is proposed outside of a plan. Thus, the Fifth Circuit was asked to address the question whether the absolute priority rule applies to settlements conducted outside of a chapter 11 plan.

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[32] *See id.* at 461 (distinguishing from *SPM* because no one disputed the lender's liens in that case, while the liens in this case were questionable due to the high-tech nature of the collateral, which included leases of low-orbiting satellites).
[33] *See id.* at 463-64 (quoting *United States v. AWECO, Inc. (In re AWECO, Inc.)*, 725 F.2d 293, 298 (5th Cir. 1984)).
[34] *Id.* at 464.
[35] *See id.* at 464 ("Rejection of a *per se* rule has an unfortunate side effect, however: a heightened risk that the parties to a settlement may engage in improper collusion. . . . The court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code.").
[36] *See id.*
[37] *See In re AWECO, Inc.*, 725 F.2d at 295.
[38] *See id.* at 296-97.
[39] *Id.* at 297.

The debtor in *AWECO* argued that the absolute priority rule cannot apply to pre-plan settlements, because the relative priorities of creditors' claims cannot be determined before a plan has been negotiated and proposed.[40] The Fifth Circuit rejected this argument for two reasons.

First, the present appeal did not require the court to consider *how* rigidly the absolute priority rule must be applied to pre-plan settlements. Said the court: "The *limited question* that we face is whether the holder of an outstanding senior claim can validly object to a proposed settlement with a junior claimant on the basis that the settlement will keep the senior claimant from being paid in full. *The answer to this question has no necessary implications beyond the present, limited context.*"[41]

Second, the Fifth Circuit explained that the policy behind the Bankruptcy Code demands that there by *some* application of the absolute priority rule, even outside the context of a chapter 11 plan.

> [W]e find the policy arguments convincing that *some* extension of the fair and equitable standard is proper. As soon as a debtor files a petition for relief, fair and equitable settlement of creditors' claims becomes a goal of the proceedings. The goal does not suddenly appear during the process of approving a plan of compromise. Moreover, if the standard had *no* application before confirmation of a reorganization plan, then bankruptcy courts would have the discretion to favor junior classes of creditors so long as the approval of the settlement came before the plan. Regardless of when the compromise is approved, looking only to the fairness of the settlement as between the debtor and the settling claimant contravenes a basic notion of fairness. An estate might be wholly depleted in settlement of junior claims -- depriving senior creditors of full payment -- and still be fair as between the debtor and the settling creditor. Our understanding of bankruptcy law's underlying policies leads us to make a *limited extension* of the fair and equitable standard: a bankruptcy court abuses its discretion in approving a settlement with a junior creditor *unless the court concludes that priority of payment will be respected as to objecting senior creditors*.[42]

In other words, the Fifth Circuit held that a bankruptcy court must consider the objecting creditors' relative priority to the settling creditor and whether the record supports a conclusion that the estate will have sufficient assets to satisfy senior claims, even after the settlement is effectuated. In that particular case, the court of appeals concluded that the record did not support the bankruptcy court's conclusion that the absolute priority rule could be satisfied upon the

[40] *In re AWECO, Inc.*, 725 F.2d at 298.
[41] *Id.* (emphasis added).
[42] *Id.* (emphasis added).

proposal of a plan, due to the conflicting testimony and evidence concerning the value and the proposed use of the debtor's remaining assets.

As it turns out, this conclusion was not so different from the Second Circuit's application of the rule in *Iridium Operating*.[43] Both courts seem to have concluded that *some* application of the absolute priority rule is required, even for pre-plan settlements, and that the bankruptcy court must consider whether the settlement will leave sufficient assets to satisfy the absolute priority rule when a plan is ultimately proposed. If the *Iridium Operating* decision could serve as an indicator for the Second Circuit's view of gifting plans, it is entirely possible that the *AWECO* decision could similarly serve as an indicator for what the Fifth Circuit would do with similar facts.

(4) *Journal Register Company*

One more opinion warrants discussion before returning to the *DBSD* opinion. In 2009, the Hon. Allan Gropper, U.S. Bankruptcy Judge for the Southern District of New York, seemingly endorsed the gifting doctrine in confirming a chapter 11 plan.[44] While that endorsement would seem contrary to *Armstrong World* and *DBSD*, a review of the plan in that case highlights when a gifting plan does or does not violate the absolute priority rule. *Journal Register* seems to remain good law, even in the face of *DBSD* and *Armstrong World*.

In the *Journal Register* plan, the debtor proposed to satisfy the senior secured lenders' claims by giving the lenders 100% of the new equity in the reorganized debtor.[45] No one disputed that the lenders were under-secured or that the reorganized debtor's new equity (having an enterprise value of about $300 million) was insufficient to satisfy the lenders' claims in full. The plan also proposed to pay unsecured creditors about 9% of their claims. But in addition to the unsecured creditors' plan treatment, the secured lenders proposed to establish a special "trade account" to pay additional trade claims, provided that the trade creditors supported the plan and released claims against the secured lenders.[46]

The plan won the overwhelming support of unsecured creditors, but one unsecured creditor in particular objected to the plan, arguing that the "gift" offered to trade creditors was unfair because it discriminated among unsecured creditors within the same class.[47] Judge Gropper overruled this argument and confirmed the plan, noting that there was legitimate business reason to support such discrimination. He further explained that the prohibition against unfair

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[43] *Compare In re Iridium Operating, LLC*, 478 F.3d at 464 ("The court *must be certain* that parties to a settlement have not employed a settlement *as a means to avoid the priority strictures of the Bankruptcy Code*.") (emphasis added) *with In re AWECO, Inc.*, 725 F.2d at 298 ("[A] bankruptcy court abuses its discretion in approving a settlement with a junior creditor *unless the court concludes that priority of payment will be respected as to objecting senior creditors*.") (emphasis added).

[44] *See generally In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D.N.Y. 2009).

[45] *Id.* at 526.

[46] *Id.*at 526-27. Notably, the plan provisions concerning the funding and distributions of the vendor account appeared in the "Means of Implementation" of the plan, instead of the "Treatment" section.

[47] *Id.* at 531-32.

discrimination in section 1129(b) of the Bankruptcy Code "is concerned with plan treatment *between* classes--not *within* classes."[48]

In dicta, Judge Gropper agreed with, but distinguished from, the Third Circuit's *Armstrong World* decision. "Here, there is no forced distribution from one class to a junior class over the objection of an intervening dissenting or objecting class. The 'gift' by a small group of Secured Lenders is wholly consensual on their part, and *there is no contention that they are making the 'gift' to another class over the dissent of an intervening class.*"[49] In other words, the objecting creditor was not being skipped over; it just was not entitled to receive distributions from the "trade account" as were other unsecured creditors within its class. Judge Gropper held that the absolute priority rule was not implicated in this scenario, and that the "gift" to the trade vendors did not violate any provisions of the Bankruptcy Code. Judge Barbara J. Houser seemed to agree with this analysis and the use of a "gift" in confirming the chapter 11 plan in *IDEARC*.[50]

D. The *DBSD* Court's Conclusion Regarding "Gifting" and the Potential Fallout

With this background, we now turn to the Second Circuit's answer in *DBSD* to the question whether property may be "gifted" around the absolute priority rule. Said the Court: "The Code extends the absolute priority rule to 'any property,' 11 U.S.C. § 1129(b)(2)(B)(ii), *not 'any property not covered by a senior creditor's lien.*"[51] Further, the court noted that property subject to a creditor's lien is still property of the bankruptcy estate.[52] Under that logic, a lien holder's *consent* to share its collateral with junior creditors could not somehow exempt the "gift" from the strictures of the absolute priority rule.

Turning to the policy arguments in support of plan gifting, the court of appeals cited various articles highlighting the benefits of plan gifting. However, the court found no legislative support for the policy arguments, and even noted stylistic changes in the various iterations of section 1129(b)(2)(B) proposed before ultimately enacted in 1978. Said the court, "[N]one [of the iterations] altered the operation of the absolute priority rule in any way relevant here."[53]

III. CLASS ACTIONS IN BANKRUPTCY

Turning to what the Fifth Circuit *has* decided, in its recent *Wilborn* decision,[54] the court reiterated that class actions are viable in the bankruptcy forum. In that case, the Fifth Circuit vacated a class certified by the bankruptcy court, but not before making clear that there is a place

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[48] *Id.* at 532 (citing 7 Collier on Bankruptcy ¶ 1129.04[4] (15th ed. rev. 1998)) (emphasis added).
[49] *Id.* (emphasis added).
[50] *See In re Idearc, Inc.*, 423 B.R. 138, 172 (Bankr. N.D. Tex. 2009) ("Finally, because the $ 3.0 million fund from which distributions will be made for Sub-Class 2 is being gifted from the Lenders' collateral -- *and will not be made from the Debtors' assets* -- any slight discrimination that could exist against claimants in Sub-Class 1 in favor of claimants in Sub-Class 2 does not violate the Bankruptcy Code.") (emphasis added) (citing with approval *Journal Register, SPM, MCorp, Genesis Health Ventures* and others).
[51] *In re DBSD N. Am.*, slip op. at 30.
[52] *See id.* at 32 (citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203-04, 103 S. Ct. 2309, 76 L. Ed. 2d 515 (1983)).
[53] *See id.* at 37 n.8 (citations omitted).
[54] *See generally In re Wilborn v. Wells Fargo Bank, N.A. (In re Wilborn)*, 609 F.3d 748 (5th Cir. 2010).

in the bankruptcy process for class actions litigation. "[I]f bankruptcy court jurisdiction is not permitted over a class action of debtors," explained the court, "Rule 7023 is virtually read out of the rules."[55]

Rule 7023 of the Federal Rules of Bankruptcy Procedure provides simply: "Rule 23 F.R.Civ.P. applies in adversary proceedings." Because the Bankruptcy Rules incorporate this rule concerning class actions, it is clear that the Advisory Committee intended for class actions to be maintainable in bankruptcy cases. But how?

Since the enactment of the Bankruptcy Reform Act of 1978 and the subsequent promulgation of the Bankruptcy Rules, many courts have considered how class actions work within bankruptcy cases. In general, class actions work two ways: multiple claimants who assert class action claims against the debtor, and, as discussed in the *Wilborn* opinion, multiple debtors who assert class action claims against a common creditor or defendant (usually a lender).

In light of the widespread use of MERS[56] and mass securitization of residential mortgages, the potential for multi-debtor class action litigation in the bankruptcy forum is especially pertinent. Further, with catastrophes such as the British Petroleum oil spill and the tsunami in Japan that may threaten downstream supply and demand, multi-creditor class actions may soon become more prevalent in bankruptcy cases. The next section of this paper discusses the trends and rules affecting "bankruptcy class actions" in light of recent decisions from the Fifth Circuit and other courts.[57]

A. Class Claims Against the Debtor

The first and, perhaps, more common type of class action seen in the bankruptcy forum is a class claim asserted against the debtor. The prime example is a personal injury or wrongful

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[55] *Id.* at 754.

[56] *See generally MERSCORP, Inc. v. Romaine,* 561 N.E. 81, 83 (N.Y. 2006) ("In 1993, the MERS system was created by several large participants in the real estate mortgage industry[] to track ownership interests in residential mortgages. Mortgage lenders and other entities, [] known as MERS members, subscribe to the MERS system and pay annual fees for the electronic processing and tracking of ownership and transfers of mortgages. Members contractually agree to appoint MERS to act as their common agent on all mortgages they register in the MERS system. . . . The initial MERS mortgage is recorded in the County Clerk's office with "Mortgage Electronic Registration Systems, Inc." named as the lender's nominee or mortgagee of record on the instrument. During the lifetime of the mortgage, the beneficial ownership interest or servicing rights may be transferred among MERS members (MERS assignments), but these assignments are not publicly recorded; instead they are tracked electronically in MERS's private system. [] In the MERS system, the mortgagor is notified of transfers of servicing rights pursuant to the Truth in Lending Act, but not necessarily of assignments of the beneficial interest in the mortgage.") (footnotes omitted).

[57] Importantly, this paper will *not* discuss in great detail the standards for class certification under Federal Rule 23 other than stating generally that a class must satisfy the four prerequisites of Rule 23(a)—numerosity, commonality, typicality and adequacy of representation—while also proving that the class may be maintained under one of the types enumerated in Rule 23(b). For a discussion of those standards, see generally *Castano v. Am. Tobacco Co.,* 84 F.3d 734 (5th Cir. 1996); *Allison v. Citgo Petroleum,* 151 F.3d 402 (5th Cir. 1998); *Sandwich Chef of Texas, Inc. v. Reliance Nat. Indem. Ins. Co.,* 319 F.3d 205, 211 (5th Cir. 2003); *O'Sullivan v. Countrywide Home Loans, Inc.,* 319 F.3d 732, 738 (5th Cir. 2003) (citing *Amchem Prods. v. Windsor,* 521 U.S. 591, 624, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997)).

death class claim against a chemical manufacturer. Once the bankruptcy case is commenced, existing class action litigation is stayed, and the class representative(s) must decide how to pursue its class claims against the debtor in the bankruptcy arena. This raises a dilemma for the class representative. Should she file a proof of claim against the debtor on behalf of the class? What if the class had not been certified before the bankruptcy case commenced? Can the named plaintiff seek certification of the class from the bankruptcy court? If so, when must the named plaintiff seek certification? Should the existing class litigation be removed to federal court? While the Fifth Circuit has not answered all of these questions directly, many other courts have.

(1) Whether the Bankruptcy Code Permits Class Proofs of Claim

In the early stages of the Bankruptcy Code, courts were unsure how to pursue or defend class actions under the Bankruptcy Code. One of the first circuit courts to address this issue concluded that the Bankruptcy Code did not authorize class actions to be asserted through a proof of claim.[58] In *Standard Metals*, the Tenth Circuit held that "class proofs of claim violate the statutory scheme of the Act and the Rules," because "each individual claimant must file a proof of claim or expressly authorize an agent to act on his or her behalf," and "a class representative cannot be considered the authorized agent of all of the creditors in a putative class."[59]

Other courts have not followed the Tenth Circuit's logic.[60] Months after the *Standard Metals* decision, the Seventh Circuit came to a different conclusion.[61] Noting that the Bankruptcy Code neither permitted nor prohibited class proofs of claim, Judge Easterbrook found section 501 of the Bankruptcy Code to provide a non-exclusive list of persons authorized to file proofs of claim.[62] Further, Judge Easterbrook noted that the use of "representational litigation" in bankruptcy was a concept dating back to the "creditors' bills" used in cases predating the Bankruptcy Act of 1898. Judge Easterbrook relied on the Supreme Court's "Yamasaki presumption"[63] that class actions are generally authorized unless Congress expressly

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[58] *See Sheftelman v. Standard Metals Corp. (In re Standard Metals Corp.),* 817 F.2d 625, 630 (10th Cir. 1987), *vacated on other grounds at* 839 F.2d 1383; *see also In the Matter of GAC Corp.,* 681 F.2d 1295 (11th Cir. 1982) (finding no authority for allowing class claims in pre-Bankruptcy Code Chapter X cases).

[59] *In re Standard Metals Corp.,* 817 F.2d at 630-32; *see also* Fed. R. Bankr. P. 2019. Courts have only departed from this logic in the last decade. As recently as 2000, Judge Abramson adopted this approach, finding that a class claimant could not establish its authority to pursue claims on behalf of putative class members as required by Rule 2019(a). *See Kahler v. FirstPlus Fin., Inc. (In re FirstPlus Fin., Inc.),* 248 B.R. 60 (Bankr. N.D. Tex. 2000); *see also In re Great W. Cities, Inc. of New Mexico,* 88 B.R. 109 (Bankr. N.D. Tex. 1988), *rev'd on other grounds,* 107 B.R. 116 (N.D. Tex. 1989). Judge Lynn addressed these opinions in *In re Craft,* discussed *infra,* and concluded that class claimants are not required to comply with Rule 2019. *See In re Craft,* 321 B.R. 189, 197 (Bankr. N.D. Tex. 2005).

[60] In fact, the *Standard Metals* court's discussion of class proofs of claims has been labeled dicta and called into serious question. *See, e.g., In re Charter Co.,* 876 F.2d 866, 869 n.4 (11th Cir. 1989) ("Therefore, despite the scope of the order vacating the original panel opinion, the discussion of the class proofs of claim in the original *Standard Metals* opinion may be dicta.").

[61] *See In the Matter of Am. Reserve Corp.,* 840 F.2d 487, 490-92 (7th Cir. 1988) (Easterbrook, J.).

[62] *Id.* at 492.

[63] *See Califano v. Yamasaki,* 442 U.S. 682, 700, 99 S. Ct. 2545, 2557, 61 L. Ed. 2d 176 (1979) ("[I]n the absence of a direct expression from Congress of its intent to depart from the usual course of trying all suits of a civil nature under the Rules established for that purpose, class relief is appropriate in civil actions brought in federal court.").

states otherwise.[64] After recognizing the pros and cons of "representational litigation" through class proofs of claim, the court concluded that class proofs of claim are valid under the Bankruptcy Code.[65]

But that conclusion did not end the analysis. For a class proof of claim to be authorized, the claimant must first obtain certification of her class. If certification was not obtained pre-petition, the only way to do so post-petition is through the invocation of Rule 23, made applicable to *adversary proceedings* by Bankruptcy Rule 7023. Claim objections generally give rise to *contested matters*, not adversary proceedings, and contested matters are governed by Bankruptcy Rule 9014, which does not *expressly* invoke Rule 7023. In *American Reserve Corp.*, Judge Easterbrook explained that, because Bankruptcy Rule 7023 is not enumerated in Bankruptcy Rule 9014, the bankruptcy judge has broad discretion in whether to invoke it.[66]

Thus, a two-pronged approach was born. In deciding whether a representative may assert a proof of claim on behalf of a putative class, courts consider, first, whether to invoke Rule 7023, and, second, whether the claimant satisfies the certification requirements of Rule 23. Of course, courts are divided on the standards applied to these prongs.

(2) When to Invoke Rule 7023

The year following the Seventh Circuit's *American Reserve* decision, the Eleventh Circuit picked up where the Seventh Circuit left off.[67] After adopting Judge Easterbrook's rationale for concluding that the Bankruptcy Code authorizes class proofs of claim,[68] the court discussed the procedural requirements for invoking Rule 7023. The court explained:

> [T]he first opportunity a clamant has to move under Bankruptcy Rule 9014, to request application of Bankruptcy Rule 7023, occurs when an objection is made to a proof of claim. Prior to that time, invocation of Rule 23 procedures would not be ripe, because there is neither an adversary proceeding nor a contested matter.[69]

In *Charter*, the claimant filed a timely proof of claim on behalf of a class of shareholders alleging securities violations.[70] Two years later, the debtors objected to the claim, and the claimant responded (within weeks of the claim objection) with a motion to invoke Rule 7023 and

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[64] *See In re Am. Reserve Corp.*, 840 F.2d at 492.
[65] *See id.* at 493.
[66] *See id.* at 493 ("Finally, the bankruptcy judge did not recognize that he has discretion under *Rule 9014* not to apply *Rule 7023* -- and therefore not to apply *Rule 23* -- in this 'contested matter.' We trust that the bankruptcy judge will exercise discretion prudently on remand.").
[67] *See Certified Class in the Charters Securities Litigation v. Charter Co. (In re Charter Co.)*, 876 F.2d 866 (11th Cir. 1989).
[68] *see generally id.* at 868-873.
[69] *Id.* at 874.
[70] *Id.* The claimant had filed a class action complaint against the debtors two weeks before the petition date. The claimant severed the debtors from his complaint and pursued the non-debtor defendants. The class was eventually certified in that action.

certify the class. The court of appeals held that, despite the two years from the time of the filing of the proof of claim, there was no undue delay in seeking certification.[71]

(3) Application of the Two-Prong Approach

Since the *American Reserve* and *Charter* decisions, several bankruptcy and district courts have expanded on the standards and procedures for invoking Rule 23 for the purposes of pursuing class proofs of claim, though not necessarily following the *Charter* court's ruling.

In *In re Craft,*[72] Judge Lynn addressed class proofs of claim filed in two different bankruptcy cases[73] with two distinctive sets of circumstances. In the Craft bankruptcy case, the claimant had obtained certification of his class pre-petition. For that claim, Judge Lynn relied on the state court's certification order, and found no extraordinary circumstances to preclude him from holding that the pre-petition class certification was sufficient to authorize the named plaintiff to file a proof of claim on behalf of the certified class.[74]

In the Mirant bankruptcy case, the claimants had not obtained certification of their classes before the bankruptcy petition date. Rather than objecting to the claims, the debtors merely moved to strike the proofs of claim as being filed on behalf of uncertified classes. In exercising his discretion to invoke Bankruptcy Rule 7023, Judge Lynn considered circumstances "peculiar to bankruptcy law," including "[1] prejudice to the debtor or its other creditors, [2] prejudice to putative class members, [3] efficient estate administration, [4] the conduct in the bankruptcy case of the putative class representatives, and [5] the status of proceedings in other courts."[75] He concluded that Bankruptcy Rule 7023 should not be invoked for a host of reasons, including detriment to the estate and its creditors because of the delay certification litigation would cause to the claims administration process and distributions. Judge Lynn also found that the putative class members would not be harmed by his refusal to invoke Bankruptcy Rule 7023, as they had received constructive or actual notice of the bankruptcy cases and the claims bar dates. Finally, in addressing the timing, Judge Lynn explained that "it is the view of this court that it is the burden of the class representatives to raise the issue of class certification."[76] In other words, Judge Lynn disagreed with the *Charter* court, where the Eleventh Circuit held two years was not too long to wait before seeking certification. Instead, it was Judge Lynn's view that a claimant should seek certification as early as possible.

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[71] *Id.* at 874-75.

[72] 321 B.R. 189 (Bankr. N.D. Tex. 2005).

[73] The issues arising from the Craft and Mirant bankruptcy cases were consolidated into a single opinion under this *Craft* citation.

[74] *See id.* at 197-98; *see also In re Entergy New Orleans, Inc.*, 353 B.R. 474 (Bankr. E.D. La. 2006) (declining to invoke Bankruptcy Rule 7023 because, under state law, no civil court had jurisdiction to consider the class certification issue until the public utilities commission determined certain regulatory issues on which the class claims were predicated).

[75] *See In re Craft,* 321 B.R. at 198-99.

[76] *Id.* at 199.

That same year, District Judge Rakoff of the Southern District of New York issued the decision in *In re Ephedra Products Liability Litigation*,[77] reaching virtually the same conclusion as Judge Lynn.

> If a party in interest asks the bankruptcy court to certify a class, the class claim becomes a "contested matter" *at least* as of the time that the request is opposed, and even before if opposition is known or reasonably foreseeable -- in the words of the Advisory Committee, "whenever there is an actual dispute." [footnote omitted] Objection to the class proofs of claim was not a necessary prerequisite to a motion for class certification.[78]

In so ruling, the *Ephedra* court expressly parted from the Eleventh Circuit's ruling in *Charter*, and ruled that a claimant cannot wait for a claim objection to seek certification.

In the *Ephedra* case, the debtors' liquidating plan had been approved for solicitation when the claimant first moved for class certification. By the time the certification motion came on for hearing, the plan had been confirmed, most other personal injury claims had been settled, and the estates creditors were ready for distribution. For these reasons, the court held that it was "simply too late in the administration of this Chapter 11 case to ask the Court to apply Rule 23 to class proofs of claim."[79]

But there was a second reason highlighted by Judge Rakoff for denying the certification motion, which other courts since have cited with agreement.[80] For a class seeking monetary damages to be certified, the putative class representative must demonstrate that "a class action is superior to other available methods for the fair and efficient adjudication of the controversy." Fed. R. Civ. P. 23(b)(3). The *Ephedra* court recognized that the bankruptcy process vitiates the superiority of class litigation.

> [S]uperiority of the class action vanishes when the "other available method" is bankruptcy, which consolidates all claims in one forum and allows claimants to file proofs of claim <u>*without counsel*</u> and <u>*at virtually no cost*</u>. In efficiency, bankruptcy is superior to a class action because in practice small claims are often "deemed allowed" under § 502(a) for want of objection, in which case discovery and fact-finding are avoided altogether.[81]

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[77] 329 B.R. 1 (S.D.N.Y. 2005).
[78] *Id.* at 7.
[79] *Id.* at 5.
[80] *See, e.g., In re Bally Total Fitness of Greater New York, Inc.*, 402 B.R. 616, 621-22 (Bankr. S.D.N.Y. 2009); *Rodriguez v. Tarragon Corp. (In re Terragon Corp.)*, 2010 Bankr. Lexis 3410 at *7-8 (Bankr. D.N.J. Sept. 24, 2010); *In re Blockbuster Inc.*, 441 B.R 239 (Bankr. S.D.N.Y. Jan. 20, 2011); *In re Motors Liquidation, Inc.*, 2010 Bankr. LEXIS 240 *33-34 (Bankr. S.D.N.Y. Jan. 28, 2011).
[81] *Id.* at 9 (emphasis added).

In other words, if the bankruptcy court is convinced that the debtors have given fair notice to potential class members (whether directly or through publication), and absent extraordinary circumstances, class proofs of claim for classes not certified pre-petition will almost never be allowed in bankruptcy cases, because courts view the general bankruptcy claims administrative process to be a superior mechanism for adjudicating claims on an individual basis.[82]

To date, few published opinions exist where a bankruptcy court has certified a class post-petition for purposes of asserting class proofs of claim. In fact, the only one found by the authors was *In re United Artists Theatre*,[83] and the facts of that case differ from the facts in the cases discussed above. In *United Artists*, there were really two classes. First, a class representative obtained relief from the bankruptcy court to continue its pre-petition class action in U.S. District Court for the District of Arizona. That relief was granted, and the litigation resulted in certification of the class and a judgment of $28.8 million.

The second class was the one addressed in this opinion, and differed from the first class. The named plaintiff in the second class action did not seek to assert a proof of claim, but merely sought a determination that the putative class members (the same as the first class) were entitled to receive distributions from the estate on account of the $28.8 million judgment. The court explained that this issue, while it may have an economic impact on the estate, really just boiled down to whether the claimants were barred by notices given in the bankruptcy case. This issue, concluded the court, could readily be made on a class-wide basis and fell under Rule 23(b)(2).[84] Accordingly, the court certified the second class, and the litigation is now awaiting approval of a settlement.

B. Multi-debtor Class Actions

The case law developed for the multi-claimant proofs of claim—the first type of bankruptcy class action—highlights the tug between due process concerns and the need for efficient administration of bankruptcy estates. However, the multi-claimant class litigation differs drastically from multi-debtor class actions—the second type of bankruptcy class action. In multi-*debtor* class actions, the issue is no longer whether to invoke Rule 7023. Instead, courts

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[82] *See generally In re Bally Total Fitness of Greater New York, Inc.*, 402 B.R. 616, 621-22 (Bankr. S.D.N.Y. 2009 (denying certification of class for claims filing purposes, finding that the debtors had given direct notice to the putative class members, and no claims had been filed before the bar date); *In re Terragon Corp.*, 2010 Bankr. Lexis 3410 at *12 (Bankr. D.N.J. Sept. 24, 2010) ("The plaintiffs, named or unnamed, received actual notice of the claim bar date by [the claims agent]. Though they may not have known of the Claimant's class proofs of claim, they had an opportunity to investigate and pursue potential individual claims and did not do so."); *In re Blockbuster Inc.*, 441 B.R 239 (Bankr. S.D.N.Y. Jan. 20, 2011) (finding that a competent court had already denied certification, and that claims for improperly charged late fees were best resolved on an individual basis).

[83] *Hacienda Heating & Cooling, Inc. v. United Artists Theatre Co. (In re United Artists Theatre Co.)*, 410 B.R. 385 (Bankr. D. Del. 2009).

[84] For an authoritative decision on whether a class may be maintained under Rule 23(b)(2) (for injunctive or declaratory relief) versus Rule 23(b)(3) (for monetary relief), see generally *Bolin v. Sears, Roebuck & Co.*, 231 F.3d 970 (5th Cir. 2000) (vacating certification under Rule 23(b)(2), finding that the only "meaningful relief" to be obtained by the multi-debtor class was for monetary damages, and requiring the district court to consider whether the class could be maintained, if at all, under Rule 23(b)(3)).

addressing multi-debtor class claims focus on jurisdiction. How far does bankruptcy jurisdiction extend where a debtor seeks to define a class of similarly situated debtors?

(1) Jurisdictional Scope

Last year, the Fifth Circuit addressed this issue directly.[85] In *Wilborn,* the Fifth Circuit concluded that "a bankruptcy judge *may* certify a class action comprised of debtors under appropriate circumstances but that the proposed class in *this* case does not satisfy the requirements of [Rule 23]."[86] In that case, the proposed class was defined as follows:

> All individuals who filed for bankruptcy under Chapter 13 in the Southern District of Texas between November 16, 2002 through November 16, 2007 who owed Wells Fargo, as servicer or holder, on a mortgage debt secured by real property, and upon whom Wells Fargo either charged, or both charged and collected, professional fees and costs during the pendency of each of their respective bankruptcy cases which were never disclosed to this Court, the debtors, or other parties-in-interest nor approved by this Court by written order entered on the docket in their respective bankruptcy cases.[87]

The "Court" defined above was defined as the U.S. Bankruptcy Court for the Southern District of Texas, regardless of the particular bankruptcy judge to which the case was assigned. Wells Fargo argued that the judge presiding over the *Wilborn* class action proceeding lacked jurisdiction over the claims arising in bankruptcy cases administered by other bankruptcy judges (though in the same jurisdictional district).[88]

Said the Fifth Circuit in rejecting Wells Fargo's theory, "We have read the jurisdictional statutes of § 1334(b) and § 157(a) as restricting the *placement* of jurisdiction in the bankruptcy courts, rather than as restricting the *scope* of bankruptcy court jurisdiction."[89] Under Wells Fargo's view, a bankruptcy court could never certify a class of debtors unless those debtors' cases had been assigned to that particular judge. But such logic, reasoned the Fifth Circuit, "would restrict a bankruptcy court's class certification authority to a proposed class of creditors rather than debtors."[90] The court found no express limitation in the rules to so limit bankruptcy class actions.

> Class actions promote efficiency and economy in litigation and permit multiple parties to litigate claims that otherwise might be

[85] As noted in footnote 84 *supra*, the Fifth Circuit did address multi-debtor class actions in *Bolin*, vacating that class certification order because the relief sought by the named plaintiffs should have been certified, if at all, under Rule 23(b)(3). While jurisdiction was discussed in the *Bolin* decision, that section focused on appellate jurisdiction, not bankruptcy jurisdiction.
[86] *In re Wilborn,* 609 F.3d at 750 (emphasis added).
[87] *Id.* at 751.
[88] *See id.* at 753.
[89] *Id.* (citing *In re Majestic Energy Corp.*, 835 F.2d 87, 90 (5th Cir. 1988)) (emphasis in the original).
[90] *Id.* at 754 (citation omitted).

> uneconomical to pursue individually. These principles are no less compelling in the bankruptcy context. We hold therefore that the bankruptcy court has authority to certify a class action of debtors whose petitions are filed within its judicial district provided that the prerequisites for a class under Rule 23 are satisfied.

Id. (citing *Am. Pipe & Constr. Co. v. Utah,* 414 U.S. 538, 553, 94 S. Ct. 756, 766, 38 L. Ed. 2d 713 (1974)).

Thus, the Fifth Circuit explained that the scope of bankruptcy jurisdiction is not restricted by which judge presided over the putative class members' bankruptcy cases. While the class in *Wilborn* only defined the class to cases filed in the Southern District of Texas, the rationale employed by the court of appeals would seem to support a much broader reach of bankruptcy jurisdiction.

(2) The Requirements Rule 23

Jurisdictional victories aside, the class claimant still must satisfy the prerequisites for certification under Rule 23.[91] As explained by the court in *Wilborn,* for a class to be maintained under Rule 23(b)(3), the monetary damages sought must be readily calculated on a class-wide basis. The class in *Wilborn,* however, could not be maintained under Rule 23(b)(3), because the damage model was too fact-specific.[92]

Just over one month after the Fifth Circuit issued the *Wilborn* decision, Judge Isgur issued an order certifying a class under Rule 23(b)(2) against Countrywide Home Loans, Inc.[93] There, Judge Isgur narrowed the class definition to cover only those individuals who were charged fees subject to Bankruptcy Rule 2016(a) disclosures that were not specifically authorized by a court order (ignoring individualized issues of notice and agreements). He further held that the certification was conditionally granted to consider whether to grant injunctive relief at trial. The proposed injunction would bar Countrywide from collecting further amounts from class members until the class members received credits for the fees charged in violation of the Bankruptcy Code and Bankruptcy Rule 2016(a).[94] As of the time of this paper, Countrywide's appeals of that opinion and a subsequent opinion denying Countrywide's motion to reconsider were pending before the Fifth Circuit.

IV. THAT PESKY EQUITABLE MOOTNESS DOCTRINE

While the doctrine of equitable mootness is neither new nor complicated, one cannot ignore the Fifth Circuit's consistent discussions of the doctrine. In the last 18 months, the Fifth Circuit

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[91] *See supra* note 57.

[92] *See In re Wilborn,* 609 F.3d at 756 ("The differing circumstances of the debtors render the reasonableness of the individual charges a fact-specific inquiry rather than a class-oriented decision.").

[93] *See Rodriguez v. Countrywide Home Loans, Inc. (In re Rodriguez),* 432 B.R. 671 (Bankr. S.D. Tex. 2010).

[94] *See* Statement of Issued Presented on Appeal, Doc. No. 392, Adversary Proc. No. 08-01004 (Bankr. S.D. Tex. Feb. 2, 2011), available on CM/ECF. The issues raised by Countrywide on appeal were whether: (1) the *Wilborn* decision applied to Rule 23(b)(2) classes; (2) a consent judgment entered in FTC litigation pending in California rendered the class complaint and proposed injunction moot; and (3) the proposed injunction was properly included in the class certification order.

has explained and applied the doctrine in over half a dozen bankruptcy appeals. This section briefly discusses the messages to be carried away from these various opinions.

A. The Equitable Mootness Doctrine in General

Equitable mootness—not to be confused with "statutory mootness" under section 363(m) of the Bankruptcy Code[95]—is a judicially created doctrine which generally applies to appeals of orders confirming chapter 11 plans.[96]

> Equitable mootness is a kind of appellate abstention that favors the finality of reorganizations and protects the interrelated multi-party expectations on which they rest. . . . The doctrine is firmly rooted in Fifth Circuit jurisprudence, as this court attempts to "strik[e] the proper balance between the equitable considerations of finality and good faith reliance on a judgment and competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting him."[97]

In deciding whether an issue is equitably moot for purposes of appeal, courts generally consider (i) whether a stay has been sought or granted; (ii) whether a plan has been substantially consummated; and (iii) whether the appellate court may grant effective relief without upsetting the expectations of third-parties who are not parties to the appeal.[98] Of the recent Fifth Circuit decisions, the following opinions demonstrate issued found to be moot.

In *Green Aggregates*,[99] the principal of two debtors appealed an order substantively consolidating the bankruptcy estates of his two companies. The bankruptcy court granted the principal's petition to take a direct appeal to the Fifth Circuit, but while the appeal was pending, the chapter 11 trustee obtained confirmation of a plan and substantially consummated that plan. The principal never sought or obtained a stay of the confirmation order, and the only relief he was seeking was the reversal of the substantive consolidation order. In light of the confirmed and consummated plan, the Fifth Circuit concluded that it could not grant the relief requested on appeal—i.e., reversal of the consolidation order—because the plan extinguished old equity and issued new equity to a third party not before the court.

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[95] *See* 11 U.S.C. § 363(m) ("The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of the sale under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.").

[96] *See In re Hilal,* 534 F.3d 498, 500 (5th Cir. 2008) ("The doctrine of equitable mootness should be and often is applied to forestall bankruptcy appeals from confirmed bankruptcy plans, because the appellate courts recognize that there is a point beyond which they cannot order fundamental changes in reorganization cases.").

[97] *Bank of New York Trust Co., N.A. v. Official Creditors' Committee (In re Pacific Lumber Co.),* 584 F.3d 229, 240 (5th Cir. 2009) (quoting *In re Manges,* 29 F.3d 1034, 1039 (5th Cir. 1994)).

[98] *See generally In re Hilal,* 534 F.3d at 500; *In re Manges,* 29 F.3d at 1039.

[99] *In re Green Aggregates, Inc.,* 345 Fed. Appx. 890 (5th Cir. Apr. 28, 2009) (per curiam).

Similarly, in *Premier Entertainment*,[100] the Fifth Circuit dismissed the appeal as equitably moot based on the specific relief sought by the appellants. In that case, the plan established an escrow fund for the appellants and other creditors to litigate over their asserted rights to the funds. Following confirmation, the debtor deposited the funds as the plan required. Nevertheless, the appellants appealed the confirmation order and continued to urge that they held superior rights to the funds. In their notice of appeal and statement of issues on appeal, the appellants framed the issues so that the only relief requested was an unfettered right to collect the escrowed funds. But in framing the issues as such, the Fifth Circuit found that the appellants effectively rendered their own issues as moot, because the same relief could be granted without the appeal.[101] Because the other parties to the litigation over the escrowed funds were not present in the appeal, and because the same relief could be granted without considering the merits of the appeal, the Fifth Circuit concluded that the issue was moot and dismissed the appeal.

B. Application to Chapter 7 Appeals?

At least two of the recent opinions addressing equitable mootness have highlighted that the purpose of the doctrine is best suited to appeals of chapter 11 plans, or orders that have an effect on confirmed chapter 11 plans. The next two decisions discuss attempts to dismiss chapter 7 appeals under theories of equitable mootness. The Fifth Circuit rejected both attempts.

In *San Patricio County*,[102] the appellants were a group of lenders entered into a sale and lease-back agreement that was ultimately unenforceable due to misrepresentations made by debtor's principal.[103] The lender sued the debtor and its principal in state court and sought to recover from proceeds of the debtor's D&O policy. The debtor filed a chapter 7 case, the trustee intervened in the lawsuits and removed them to the bankruptcy court. Once in the bankruptcy court, the trustee obtained a ruling that the insurance proceeds were property of the debtor's bankruptcy estate. The bankruptcy court then approved a settlement with the insurance carriers, and the trustee began distributing proceeds.[104] The lenders sought to stay the approval orders, but were denied. They appealed to the district court, but after three-quarters of the settlement proceeds were distributed, the trustee moved to dismiss the appeal as equitably moot. The district court granted the motion.[105]

In *San Patricio County*, the Fifth Circuit held that the appeal was not equitably moot, because the lenders sought a determination that the lawsuit against the debtor's principal should not have been removed to federal court. The Fifth Circuit noted that, if successful, the proceeds

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[100] *In re Premier Entm't Biloxi LLC v. Pac. Inv. Mgmt. Co. (In re Premier Entm't Biloxi LLC)*, 2009 U.S. App. LEXIS 12672 (5th Cir. June 9, 2009).

[101] *Id.* at *11 (finding that considering the appeal "would necessarily involve overturning the provisions of the confirmed plan that establish the escrow funds and the adversary proceeding")

[102] *Tech. Lending Ptrs., LLC v. San Patricio County Cmty. Action Agency (In re San Patricio County Cmty. Action Agency)*, 575 F.3d 553 (5th Cir. 2009).

[103] *Id.* at 555-56.

[104] *Id.* at 556-57.

[105] *See id.* at 557.

would not have been property of the debtor's bankruptcy estate, and would be available to satisfy the lender's claims.[106] Said the court in finding such relief to be available:

> This case involves the payment of money to parties who were before the bankruptcy court, with three-quarters of the settlement being paid to the either [the trustee] or the state of Texas. We realize that the money paid to the state was then to be given to a comparable charity or charities. Still, we do not find the fact to create a hardship in this case sufficient to outweigh the general right of dissatisfied litigants to have a review of their appellate issues.[107]

While noting that it was unclear whether equitable mootness had *any* application to chapter 7 appeals, the Fifth Circuit concluded that it had no application to the present appeal.[108]

Then, in *Bodenheimer*,[109] the Fifth Circuit again considered whether equitable mootness applied to an appeal of a chapter 7 order. The court once against declined to apply the doctrine broadly, but also held that the particular appeal was not moot. In that appeal, a partner of the chapter 7 debtor argued that the bankruptcy court improperly awarded fees to the debtor's state appointed liquidator. The liquidator argued that the appeal was equitably moot because the chapter 7 trustee had made all distributions and closed the case. The court again considered what effective relief could be granted on appeal, noting that "the only relevant party in interest not before the court is the liquidated estate, which is not truly a 'third-party' in the bankruptcy but a central litigant whose assets remain at issue."[110] As it did in *San Patricio County*, the Fifth Circuit concluded that the *Bodenheimer* appeal was not equitably moot. The court held that reopening the bankruptcy case to consider whether to redistribute assets "would not upset the liquidation plan or disturb the settled interests of parties not before the court."[111]

The reasoning from these two chapter 7 appeals highlights a perceived difference in the Fifth Circuit between appeals of orders affecting chapter 11 plans and orders affecting chapter 7 liquidations. In the latter, third-party creditors are not harmed by an appeal that could lead to further distributions. On the other hand, as discussed below, issues may become equitably moot in chapter 11 appeals, if it means that some of the third-party creditors would have to give their distributions back to the debtor.

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[106] *See id.* at 558-59.
[107] *Id.* at 559.
[108] *See id.* at 558 ("It is certainly arguable that equitable mootness has no application to an appeal in a Chapter 7 liquidation. Yet, there is no reason to make such a comprehensive statement here. Instead, we find that under traditional equitable mootness analysis, this case is not moot.").
[109] *Szwak v. Earwood (In re Bodenheimer, Jones, Szwak, & Winchell, LLP)*, 592 F.3d 664 (5th Cir. 2009).
[110] *Id.* at 669.
[111] *Id.* at 670.

C. Focus on the Remedies Available

In recent decisions, the Fifth Circuit has reminded us that rote incantations of equitable mootness are insufficient to preclude appellate review. In other words, it is not enough that a plan has been substantially consummated and no stay was obtained (the first two factors of the mootness inquiry). Instead, the Fifth Circuit puts most weight on the final factor—whether effective relief may be granted without upsetting expectations of third parties not before the court.

Take *Pacific Lumber* for example. The appellants raised six issues on appeal. Out of these six issues, the Fifth Circuit found only two to be equitably moot.[112] For those issues, the court noted that certain unsecured creditors had already received payment under the plan, and they were not parties to the appeal.[113]

On the other hand, the court *did* consider the merits of the remaining four issues, including: (i) whether the plan satisfied requirements for cramdown (specifically, whether the noteholders received the "indubitable equivalent" of their secured claim); (ii) whether the plan amounted to a *de facto* consolidation of the debtors' estates; (iii) whether the bankruptcy court properly calculated the appellants' administrative priority claim; and (iv) whether the plan's third party releases and exculpation clauses were valid. While one could legitimately argue that overturning any one of these issues would seriously threaten the success of the plan, the Fifth Circuit disagreed. Said the court on the potential impact of its review on the plan:

> That there might be adverse consequences to [the appellees] is not only a natural result of any ordinary appeal—one side goes away disappointed—but adverse appellate consequences were foreseeable to them as sophisticated investors who opted to press the limits of bankruptcy confirmation and valuation rules.[114]

Then, last year, the Fifth Circuit again considered issues arising from the *Pacific Lumber* case.[115] This time, the court considered the amount of the section 507(b) superpriority administrative claim awarded to the note holders. The debtors and plan proponents again argued that consideration of the issue would seriously undermine the success of the confirmed plan.[116] The court of appeals however rejected the mootness argument, noting that "so long as there is the

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[112] Those issues were: (1) whether the plan artificially impaired one class and gerrymandered classes to obtain a consenting, impaired class; and (2) whether the plan unfairly discriminated against the appellants' deficiency claims.
[113] *In re Pac.Lumber Co.*, 584 F.3d at 251 ("Third-party expectations cannot reasonably be undone, and no remedy for the Noteholders' contentions is practicable other than unwinding the plan.").
[114] *Id.* at 244.
[115] *Bank of New York Trust Co., NA v. Pac. Lumber Co. (In re SCOPAC)*, 624 F.3d 274, 282 (5th Cir. 2010).
[116] *Id.* at 281.

possibility of 'fractional recovery,' the Noteholders need not suffer the mootness of their claims."[117]

Notwithstanding the Fifth Circuit's conclusions on equitable mootness in the *Pacific Lumber* and *SCOPAC* appeals, there are some issues that are easier cases for equitable mootness. For example, in *Asarco*, there were two competing plans which both satisfied confirmation requirements, but the district court chose one over the other and confirmed it. The unsuccessful plan proponents appealed without obtaining a stay of the confirmation order, and that confirmed plan was substantially consummated. On appeal, the unsuccessful plan proponents asked the Fifth Circuit not to unwind the consummated plan, but merely to substitute the appellants as the primary equity-holders of the reorganized debtors, as proposed under their unsuccessful plan. "There is ample reason to think that substituting Sterlite as the primary equity-holder would have a far-reaching impact. It would be difficult to maintain anything resembling the status quo if the primary equity holder were replaced by Sterlite."[118] Finding that a change in equity holders would affect "numerous complex financial transaction," the Fifth Circuit dismissed the appeal on mootness grounds.

In these recent decisions, the Fifth Circuit has highlighted at least a few important factors to consider when raising or responding to an appeal. First, the statement of issues must be crafted in a manner that, if successful, provides at least a "fractional recovery" that may be granted by the appellate court. Second, the appellant should give thought to who should be a party to the appeal, as having the affected parties present on appeal may carry significant weight what the appellate court is able to consider in light of equitable mootness concerns. Third, in moving for dismissal on equitable mootness grounds, the appellee should consider whether the relief requested may be granted, at least fractionally.

[117] *Id.* at 282; *see also Alberta Energy Ptrs. v. Blast Energy Servs., Inc. (In re Blast Energy Servs., Inc.),* 593 F.3d 418 (5th Cir. 2010) (reversing district court's order, finding that appeal was not equitably moot because relief *could* be granted where the parties stipulated that the issue could be reviewed on appeal without affecting the plan).

[118] *In re Asarco, LLC,* slip op. at 4, Case No. 09-41259 (5th Cir. Nov. 12, 2010).

SELECTED TOPICS: CLASS ACTIONS IN BANKRUPTCY

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A. Statutory Framework

Outside bankruptcy, the requirements for commencing a class action are set forth in Rule 23 of the Federal Rules of Civil Procedure. Rule 23(a) imposes four threshold criteria: (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class. The common monikers of these prerequisites are numerosity, commonality, typicality and adequacy of representation.

Rule 23(b) sets forth four additional alternative requirements.

> (1) separate actions by or against individual members of the class would create a risk of
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> (A) inconsistent ruling and incompatible standards of conduct for the party opposing the class, or
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> (B) individual adjudications which practically would be dispositive of the claims of other nonparty members; or
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> (2) the party opposing the class has acted (or refused to act) on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
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> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

Fed.R.Civ.P. 23(b).

The statute lists the factors pertinent to the last of these tests, whether common issues predominate or the class action is superior to other methods, as follows:

> (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions;
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> (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the difficulties likely to be encountered in the management of a class action.

Fed.R.Civ.P. 23 (b)(3)(a-d).

Under the Federal Rules of Bankruptcy Procedure, Fed.R.Civ.P. 23 is made applicable to adversary proceedings *in toto* through Bankruptcy Rule 7023. In turn, Rule 7023 is referenced in Bankruptcy Rule 9014 as one of the subset of adversary rules that are also applicable to contested matters, such as claims proceedings. Thus class litigation may occur in bankruptcy courts both as stand-alone litigation, in the case of removed class actions or those initiated in the bankruptcy case as adversary complaints, or in the context of proofs of claim filed on behalf of a putative class of creditors.

B. Permissibility of Class Claims in Bankruptcy

While there remains mixed authority on the issue, most courts have held that because the Federal Rules of Bankruptcy Procedure incorporate Fed.R.Civ.P. 23, it is possible to file class claims in bankruptcy cases. The first court of appeals to address whether class proofs of claim may be filed in bankruptcy cases was the Tenth Circuit, which ruled that such claims are not permitted. In re Standard Metals Corp., 817 F.2d 625 (10th Cir.), *vacated in part on reh'g and decided on other grounds sub nom.* Sheftelman v. Standard Metals Corp., 839 F.2d 1383 (10th Cir. 1987). The court of appeals reasoned that while class claims are not specifically authorized or prohibited, the filing of a class claim runs afoul of Bankruptcy Rule 3001(b), which requires that a proof of claim be executed by the creditor or the creditor's authorized agent. 817 F.2d at 631-32. The court further reasoned that "class proofs of claim are unnecessary in a bankruptcy proceeding," since the bankruptcy court's control over the estate eliminates the problem of repetitious litigation in multiple forums. Id. at 632. The Tenth Circuit repeated its disapproval

in In re Unioil, 962 F.2d 988, 992 (10th Cir. 1992). *See also* In re Johns-Manville Corp., 53 B.R. 346 (Bankr. S.D.N.Y. 1985); In re Woodmoor Corp., 4 B.R. 186 (Bankr. D. Colo. 1980); In re FIRSTPLUS Financial, Inc., 248 B.R. 60 (Bankr. N.D. Tex. 2000).

In FIRSTPLUS, the court held that the proposed class representative could not be regarded as an "authorized agent" with authority to file a class proof of claim on behalf of the class. The claim derived from a class action complaint that had been pending in federal district court in which no class had yet been certified prior to the imposition of the automatic stay. Each member of the putative class member had received actual notice of the class action and of the bar date for filing claims in the case. Based on such notice, the court found that those who had not filed claims were now barred from doing so and that certification of a class was unwarranted.

Most courts of appeal, on the other hand, have held that bankruptcy courts have discretion to consider class claims, if circumstances warrant. The reasoning of these opinions rests on a literal application of the Bankruptcy Rules. Objections to claims are classified as "contested matters" under Bankruptcy Rule 9014. That rule, in turn, includes Bankruptcy Rule 7023 among the procedural rules applicable to contested matters, and Bankruptcy Rule 7023 in turn incorporates verbatim Rule 23 of the Federal Rules of Civil Procedure. *See* Reid v. White Motor Corp., 886 F.2d 1462 (6th Cir. 1989) *cert. denied* , 494 U.S. 1080 (1990) (recognizing possibility of class claims but affirming dismissal on procedural grounds); In re American Reserve Corp., 840 F.2d 487 (7th Cir. 1988); In re Charter Co., 876 F.2d 866, 873 (11th Cir. 1989), *cert. dismissed*, 496 U.S. 944 (1990); In re Birting Fisheries, Inc., 92 F.3d 939 (9th Cir. 1996). *See also* In re First Alliance Mortgage Co., 269 B.R. 428, 444 (C.D. Cal. 2001) (certifying class claim where class action had been commenced prepetition but not certified prior to bankruptcy); In re Trebol Motors Distrib. Corp. 220 B.R. 500, 502 (1st Cir. BAP 1998) (permitting class proof of claim where class had already been certified and obtained a judgment prepetition); In re Amdura Corp., 170 B.R. 445 (D. Colo. 1994); In re Zenith Laboratories, Inc., 104 B.R. 659, 662 (D.N.J. 1989).

Most bankruptcy court decisions are in accord. *See* In re Commonpoint Mortgage Co., 283 B.R. 469 (Bankr. W.D. Mich. 2002); In re Beck, 283 B.R. 163 (Bankr. E.D. Pa. 2002); In re Kaiser Group International, Inc., 278 B.R. 58 (Bankr. D. Del. 2002); In re First Interregional Equity Corp., 227 B.R. 358 (Bankr. D. N.J. 1998); In re Woodward & Lothrop Holdings, Inc., 205 B.R. 365, 369-70 (Bankr. S.D.N.Y. 1997) (expunging class proof of claim for failure to satisfy Rule 23, but noting that the Southern District of New York allows class proofs of claim when Rule 23 is satisfied); Iles v. LTV Aerospace and Defense Co. (In re Chateaugay Corp.), 104 B.R. 626, 627 (S.D.N.Y. 1989); In re Mortgage & Realty Trust, 125 B.R. 575 (Bankr. C.D. Cal. 1991); In re Thomson McKinnon Securities Inc., 150 B.R 98 (Bankr. S.D.N.Y. 1992) (disallowing class claim for failure to meet Rule 23 requirements); In re Great Western Cities Inc., 88 B.R. 109, 112 (Bankr. N.D. Tex. 1988). *Cf.* Bailey v. Jamesway Corp. (In re Jamesway Corp.), 1997 Bankr. LEXIS 825 *9-10 (Bankr. S.D.N.Y. 1997) and In re Sacred Heart Hosp. Of Norristown, 177 B.R. 16 (Bankr. E.D. Pa. 1995) (certifying classes but only where class had not received notice of the bar date or had been certified prepetition).

C. A Higher Standard for Certification of Class Claims?

Most courts that have approved the filing of class proofs of claim have indicated that their allowance is discretionary. *See, e.g.*, American Reserve, 840 F.2d at 492. In American Reserve, the court of appeals questioned the utility of exercising that discretion in many cases, citing factors that would be present in nearly all bankruptcy cases. The guidance offered by the Court of Appeals suggests a *de facto* limitation on class certification that is not present in the non-bankruptcy context.

> Plaintiffs and their champions at the bar hold the benefits of class litigation in higher esteem than do courts. The efficiency benefits of consolidation to one side—because bankruptcy achieves them without the need for class suits—class actions are a headache for judges.... Class actions consume judicial time ... [and] they impose

> steep costs on defendants, even those in the right. The systemic costs of class litigation should not be borne lightly.
>
> More, an action with modest stakes per claimant—the kind of claim that would not be pursued without a class device—is a lawyer's vehicle in the best of times.... Because the lawyer-champion is interested in his reward, which will be less than the total gain of the class, the lawyer may settle too quickly rather than risk all in exchange for the prospect of a higher recovery he will not obtain, or the lawyer may accept a settlement package slanted in favor of the fees component.... The plaintiffs' stake is even smaller in bankruptcy class actions. Instead of litigating for the actual injury of $10 or $1,000 apiece, members of the class are litigating for a judgment that will be satisfied only in part (perhaps 10% of $10), as other creditors' claims also are written down. **As the stake goes down, so does the utility of the class device (net of its substantial costs)**
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> * * *
>
> ...If a class action would greatly complicate a bankruptcy, without yielding significant compensation to injured parties, the marginal deterrence would not be worth the candle.
>
> * * *
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> The problems we have discussed could lead people to conclude that the Bankruptcy Rules should not authorize class actions. But they do, and these considerations do not show that it is always such a bad idea to allow class actions in bankruptcy that courts should deny these Rules their ordinary meaning. **Suits for very small stakes may hold out little prospect of either compensation or deterrence; the bankruptcy court may exercise discretion to reject these, for both Rule 9014 and Rule 23 give the court substantial discretion to consider the benefits and costs of class litigation.**

Id. at 491-92 (emphasis added).

After reviewing the Bankruptcy Code and Rules, and concluding that Section 501 of the Code and Bankruptcy Rule 3001(b) do not preclude application of Bankruptcy Rule 7023 to class claims, the court remanded the case for further consideration, noting:

> **The bankruptcy judge has yet to consider the features, which we have discussed, that may make class certification less desirable in bankruptcy than in ordinary civil litigation.**

Id. at 493 (emphasis added).

This lukewarm endorsement of class claims was echoed in In re Thomson McKinnon Securities, Inc., 150 B.R. 98 (Bankr. S.D.N.Y. 1992), where the court stated: "In view of the unsettled status of class claims in bankruptcy cases, a court should not exercise its discretion in applying Federal Rule of Bankruptcy Procedure 7023 for purposes of authorizing class certification unless it clearly appears that the criteria expressed in Federal Rule of Civil Procedure 23 have been satisfied, assuming that class proofs of claim are allowed in bankruptcy cases." Id. at 100.

The court was more scathing in In re Woodward & Lothrop Holdings, Inc., *supra*. There, the putative class representative had proposed a settlement in ADR that gave bedding customers 20% discounts good for 90 days, and paid his counsel $250,000. Invoking the American Reserve court's admonition that a class action involving small claims is a "lawyer's vehicle in the best of times," the court stated: "It may be hard to quantify the value of the proposed discount, but a lot of people will have to buy a lot of sheets and pillows within 90 days to justify a legal fee of $250,000." 205 B.R. at 377. Certification of the class claim was denied.

The overlay of bankruptcy on class certification standards is typified by In re Mortgage & Realty Trust, *supra*. After reciting the Rule 23(a) requirements for class certification,[1] Judge Bufford proceeded to analyze whether, under Rule 23(b)(3), a class action "is superior to other available methods for the fair and efficient adjudication of the controversy," as follows:

> In determining the propriety of certification of a class claim in a bankruptcy case, the Court must assess whether the benefits that generally support class certification in civil litigation are realizable in the bankruptcy case. . . . **If a class action would greatly complicate the bankruptcy case without yielding significant compensation to the injured parties, the marginal deterrence to wrongdoers would not be worth the effort.**

125 B.R. at 580. In certifying a class, the court emphasized the following considerations:

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[1]/ (1) The class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class. Fed.R.Civ.P. 23(a).

* nobody was challenging certification, thereby avoiding "the complexities of class certification";

* other distributions would not be delayed, since all other creditors were senior in priority;

* the debtor's exposure was "minor" in relation to its assets, and the debtor could "simply reserve an appropriate fund to cover the entire exposure on the class claim without impacting the remainder of the plan";

* the case was a surplus case and thus could yield significant compensation;

* "compensation to the class will not detrimentally impact other creditor classes"; and

* notice to class members had been inadequate.

Id. at 580-81.

Obviously, these considerations would not be present in many bankruptcy cases. Certification will typically be opposed and present complex issues. Absent some basis for subordinating such claims to other unsecured nonpriority claims in the case, the existence of an unliquidated class claim could easily delay plan distributions. It could even stymie the plan confirmation process at the disclosure stage if it prevented adequate disclosure to creditors of their likely recoveries. Exposure will frequently be more than "minor" in relation to assets. And there are relatively few surplus cases, in which compensation to the class would not "detrimentally impact" other creditor classes. To the extent the same criteria are applied by other bankruptcy courts, they would present a significant hurdle to class certification in many cases.

Accordingly, while the formal standard for class certification may be the same as in nonbankruptcy courts, there may exist a *de facto* higher standard for class certification in a bankruptcy case. This may be seen as reflecting an inherent tension between class actions and bankruptcy cases. There are two important features of bankruptcy cases that may not be present in the nonbankruptcy context. First, there are frequently extremely limited resources for the payment of debts, and second, the resources that exist must ordinarily be distributed pro rata among unsecured nonpriority creditors, rather than on a 'first come, first serve' basis. This means that certification of a class may well generate a claim that dwarfs those of other unsecured

creditors. Particularly where the class is composed of large numbers of persons with relatively small claims, a bankruptcy court may well be reluctant to certify a class that would dramatically reduce the recovery of other creditors perceived as more 'legitimate,' such as trade creditors or lenders.

There are countervailing considerations. In a recent decision in the pending chapter 11 case of InaCom, Inc., Chief Judge Walsh of the Delaware Bankruptcy Court certified a class of WARN Act claimants, and spoke positively of the class procedure as simplifying the administrative burden of dealing with hundreds or thousands of individual claims. This sentiment is echoed in many of the class certification decisions. Even further, the court held in In re Mortgage & Realty Trust, *supra*, that once a class is certified, the class representatives can vote on behalf of the class, which would obviously streamline the solicitation process. 125 B.R. at 582-583. This presents the problem of how to treat the votes of class members who cast individual ballots, whose voting rights are theoretically displaced by the class representative. The Mortgage & Realty Trust court resolved this inconsistency as only a bankruptcy court could: the votes of individual class members who had cast ballots would stand, while the class representative voted for everyone else. Id. The same solution was utilized in In re American Family Enterprises, 256 B.R. 377, 404 n. 20 (D.N.J. 2000).

There is one avenue to class certification that could arguably be easier to satisfy in bankruptcy than outside. Rule 23(b)(1)(b) provides that, if the threshold requirements of numerosity, commonality, typicality and adequacy of representation are met, a class action may be maintained if:

> (1) the prosecution of separate actions by or against individual members of the class would create a risk of
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> * * *
>
> (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests . . .

Fed.R.Civ.P. 23(b)(1)(B). This includes situations where clams are made against a particular fund that is insufficient to satisfy all such claims – the so-called "limited fund action." *See* In re Madison Associates, 183 B.R. 206, 217 (Bankr. C.D. Cal. 1995). Madison Associates, however, involved a class action against nondebtor parties. In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285 (2d Cir. 1992), involved a settlement of class securities fraud litigation against the debtor. The Second Circuit recognized that the "limited fund" principle underlying Rule 23(b)(1)(B) could have the potential to mandate class certification against debtors in nearly every bankruptcy case, and rejected such a broad application. The court noted that Rule 23(b)(1) is intended to address and avoid scenarios where similar claims are resolved and paid on a "first-come first-serve" basis, and that this is not how claims are resolved and paid under the Bankruptcy Code. The court concluded: "Accordingly, a mandatory class action will not be appropriate in most bankruptcy cases." Id. at 292. Ironically, though, it affirmed class certification on just the type of facts that would typically be present in most bankruptcy cases, *i.e.*, that individual litigation would deplete the estate and reduce recoveries. The Drexel court attempted to distinguish its case on the basis that some claimants might pursue costly individual litigation in the belief that their cases were more meritorious than others, unfairly diminishing the return to others. Id. To call that a "distinction without a difference" might be an overstatement.

Because the statutory guidelines for class certification are the same in bankruptcy and nonbankruptcy courts, a bankruptcy court ruling on class certification may have a significant impact on related proceedings. For instance, a class claim could be filed against a debtor corporation at the same time as a state or federal court class action was initiated against nondebtor parties. Or a class claim might be filed against a debtor defendant that was previously a party to already pending class litigation. In certain circumstances, a decision on class certification in one court could be conclusive in the parallel proceeding. *Compare In re Livaditis*, 122 B.R. 330, 334-35 (Bankr. N.D. Ill. 1990), *aff'd in part and rev'd in part*, 963 F.2d

1012 (7th Cir. 1992) (prior class certification in district court is collateral estoppel when debtor had been a party to that action) and In re Mortgage & Realty Trust, *supra* (class certification in district court was not preclusive because debtor was not a party). Even if not conclusive, it is highly likely that such a determination would have substantial influence in the parallel proceeding.

Accordingly, if there are pending parallel proceedings, counsel on each side may have competing procedural objectives. To the extent the particular facts of a bankruptcy case make class certification appear less likely, defense counsel may seek to expedite bankruptcy court consideration of class certification, while class counsel would obviously have the reverse incentive. A perceived difference in standards may also heighten the incentives and risks of removal of class actions to bankruptcy court and efforts to obtain remand to their court of origin.

D. Class Claims vs. Bar Dates

An interesting issue that arises in the context of class claims is whether persons who received notice of the deadline for filing claims but failed to submit timely proofs of claim may nonetheless be class members, thereby circumventing the bar date.

Arguably, claimants who received actual notice of the bar date should not be permitted to join a proposed class. *See* In re Jamesway Corp., 1997 WL 327105 (Bankr. S.D.N.Y. 1997); In re Sacred Heart Hospital of Norristown, 177 B.R. 16, 24 (Bankr. E.D. Pa. 1995); *see also* In re First Plus Financial, Inc., 248 B.R. 60, 73 (Bankr. N.D. Tex. 2000) (allowance of a class proof of claim that effects an extension of the bar date for the putative class would "be inequitable within the proposed class since approximately 2,000 of those people, recognizing their rights and concomitant duties as creditors of the Debtor, [timely] filed their individual proofs of claim").

In Sacred Heart, the court, in a liquidating Chapter 11 case, denied a motion to permit the filing of a class proof of claim and certify a class of employees allegedly terminated in violation

of the WARN Act. All the terminated former employees had received notice of the bar date. The Court assessed the impact of the motion on the bar dates established in the bankruptcy case. 177 B.R. at 22. "[I]f the putative unnamed class members have clearly received actual or constructive notice of the bankruptcy case and the bar date, denial of the implementation of the class proof of claim device appears advisable." Id.[2] The court also opined that permitting such claims would violate the rights of those who had filed timely claims:

> Known claimants of all kinds who have received actual notice of the bar date must proceed through the claims process on a level playing field. Tinkering with an established bar date may raise due process claims of parties who have timely filed claims by originally-established bar dates, since it gives late filers a second bite at the apple which is likely to be less than fully satisfying, and thus effect unfair diminution of the timely filer's share of a distribution.

Id. at 22-23 (emphasis added). Similarly, in Jamesway, the court denied plaintiff's motion for class certification and noted:

> If we certify the class, we will effectively extend the bar date to those employees who have not timely filed WARN Act claims herein . ... To do so would be "unwarranted, unfair, and possibly violate the due process rights of other creditors." Sacred Heart, 177 B.R. at 24. Under the facts of this case, we find that the Proposed Class should not be certified and we deny the [class certification] motion.

Jamesway, (1997) WL 327105 at 11; *accord* In re First Plus Financial Inc., 248 B.R. 60, 78 (N.D. Tex. 2000) (court denied a motion for class certification that would have the effect of extending the bar date for the putative class members).

Other courts have rejected this reasoning and permitted classes to include members who failed to file proofs of claim. In In re Kaiser Group International, Inc., 278 B.R. 58 (Bankr. D.

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[2]/ Although the court concluded that a class proof of claim that results in the extension of the bar date may be appropriate, the circumstances that justify such relief are rare. 177 B.R. at 22. The court distilled the case law dealing with class certification motions and found that there are two instances where courts grant class certification motions which result in a *de facto* extension of the bar date. The first is when the class has been certified prepetition. Id. at 21-22. The second is when the notice of the case or bar date is inadequate or where unnamed class members are in large part "unknown creditors." Id. at 22. Obviously, neither of these situations is present here.

Del. 2002), the court stated:

> The Debtors also argue that we should consider whether it is appropriate to give class members an opportunity to participate in the class if they did not file proofs of claim before the bar date. The Debtors argue this gives class members an extension of the time within which to file a claim. [citing Sacred Heart] The Claimant, however, did file the class proof of claim before the bar date. If the class claim is certified, then the claims of all the members of the class are incorporated in the proof of claim that was timely filed. This is inherent in class actions. For example, the filing of a class action tolls the statute of limitations otherwise applicable to all class members in their individual capacities. See, e.g., Bailey v. Sullivan, 885 F.2d 52, 65 (3d Cir. 1989). The Debtors are not prejudiced by this, since the Debtors had notice of the existence of the class claim before the bar date.

Id. at 63-64. The argument was also rejected in In re First Alliance Mortgage Co., 269 B.R. 428 (C.D. Cal. 2001). In response to arguments that the finality of the bar date is integral to the bankruptcy process, the court noted that the bar date serves only to prevent prejudice to creditors whose anticipated return is unexpectedly reduced by late claims. The court held that no such unfair surprise occurs when a timely class claim is filed. "This is not a case where the debtor has fashioned a plan of reorganization only to be surprised when a Johnny-come-lately creditor asserts a cause of action against the estate, throwing the bankruptcy case into disarray." Id. at 439.

If the rationale for strict compliance with the bar date is that individuals must file their own claims, that is inconsistent with the concept of class claims and the reasoning of those courts that accept them. As the Seventh Circuit noted in American Reserve:

> The district court's observation that '[c]lass proofs of claim would . . . permit creditors who have not made the minimal effort to file a proof of claim to participate in the distribution of the estate, perhaps at the expense of unsecured creditors who properly filed a proof of claim but whose claims were subordinate to those of the class members' . . . is an argument in favor of the class device. The members of the class may be entitled to compensation, and if this can be achieved without surplus paperwork so much the better.

840 F.2d at 489 n.3. *See also* Charter, 876 F.2d at 871 ("the efforts and cost of investigating and initiating a claim may be greater than many claimants' individual stake in the outcome,

discouraging the prosecution of these claims absent a class action filing procedure."). If instead the rationale rests upon concepts of finality and avoiding unfair surprise, those concerns should be met by the timely filing of a class claim, or perhaps even a nominally late filing where the 'informal proof of claim' doctrine is satisfied, *e.g.*, where a nonbankruptcy class action had been commenced such that the debtor was well aware of existence of both the class and the claim.

E. Class Action Adversary Proceedings

The legal basis for a bankruptcy court to act as a forum for class action lawsuits is less problematic than for class proofs of claim. For the latter, as noted, Bankruptcy Rule 3001, which requires claims to be submitted by authorized agents, appears to be in conflict with Rules 9014 and 7023, on the other, which apply Fed.R.Civ.P. 23 to contested matters. In adversary proceedings, on the other hand, Rule 23 is made directly applicable by Bankruptcy Rule 7023 and is not inconsistent with any other Bankruptcy Rule.

Thus the bankruptcy court can serve as the forum for class actions brought by creditors against a debtor, by the debtor against third parties, or even by third parties against other third parties. *See, e.g.*, In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 292-93 (2d Cir. 1992) (by creditors in consolidated class actions against debtor for securities fraud); First Federal Bank of Michigan v. Barrow, 878 F.2d 912 (6th Cir. 1989) (by trustee against class of creditors to recover preferences pursuant to a common scheme); In re Broadhollow Funding Corp., 66 B.R. 1005 (Bankr. E.D. N.Y. 1986) (by debtor against class of investors for declaratory relief to determine equitable ownership of mortgages); In re Braniff Airways, Inc., 22 B.R. 1005 (Bankr. N.D. Tex. 1982) (by debtor and pension plan administrators against trustees and beneficiaries of plans); In re Wholesale Furniture Mart, Inc., 24 B.R. 240, 242-43 (Bankr. W.D. Mo. 1982) (class action adversary proceeding by creditors against nondebtors combined with equitable remedies against debtor); In re Madison Associates, 183 B.R. 206 (Bankr. C.D. Cal. 1995) (by partnership

creditors against partners of debtor for partnership deficiencies); In re Appliance Store, Inc., 158 B.R. 384 (Bankr. W.D. Pa. 1993) (by class of former employees against secured creditor); In re Watts, 76 B.R. 390 (Bankr. E.D. Pa. 1987) (by class of 16 debtors for injunctive relief against state officials).

In one creative use of class actions in bankruptcy, former employees of a debtor were certified as a class for purposes of suing the debtor's secured creditor to surcharge the proceeds of sale of the lender's collateral under Bankruptcy Code § 506(c). In re Appliance Store, Inc., 158 B.R. 384 (Bankr. W.D. Pa. 1993). The court rejected efforts by the defendant to defeat class certification by drawing distinctions between employees, stating in essence that each employee had played a role in preserving the value of the lender's collateral.

It might appear more efficient to permit a creditors' committee to prosecute such claims in place of utilizing a class action. Creditors' committees, however, have been held to lack the ability to act as a class representative, both because it would expand the Committee's role beyond the apparent intent of the Bankruptcy Code and because representing a class of creditors would present a conflict of interest vis-à-vis the Committee's representation of the entire creditor body. In re Continental Airlines, Inc., 57 B.R. 839, 841 (Bankr. S.D. Tex. 1985); *but see* In re Butler, 94 B.R. 433 (Bankr. N.D. Tex. 1989) (post-dismissal committee was no longer a statutory committee and thus could not prosecute class action, although individual members could sue as class representatives).

The only limitations on the bankruptcy court's authority to hear class actions are jurisdictional. 28 U.S.C. § 1334(b) confers original but nonexclusive jurisdiction upon district courts over civil proceedings arising under title 11, or arising in or related to cases under title 11. "Related" proceedings are consistently and broadly defined to include any that could conceivably affect the bankruptcy estate. *See, e.g.*, Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984); In re Canion, 196 F.3d 579 (5th Cir. 1999). 28 U.S.C. § 157 permits district courts to refer all such matters to bankruptcy judges, and sets forth a list of core proceedings that bankruptcy judges

may hear and determine. 28 U.S.C. § 157(a) and (b). Such authority may be exercised in non-core proceedings only with the consent of the parties. 28 U.S.C. § 157(c). Although a proceeding to allow or disallow a claim is ordinarily "core," carved out from this jurisdictional grant are "the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11." 28 U.S.C. § 157(b)(2)(B).

These jurisdictional boundaries have been tested in efforts to use bankruptcy courts as platforms to launch class actions on behalf of classes of chapter 7 debtors damaged by the improper bankruptcy practices of consumer credit institutions, of the sort that have attracted much criticism in recent years. *See, e.g.*, In re Williams, 244 B.R. 858 (S.D. Ga. 2000) (against Sears based on reaffirmation practices); In re Noletto, 244 B.R. 845 (Bankr. S.D. Ala. 2000) (against Nationsbanc based on improper loan charges); In re Nelson, 234 B.R. 528 (Bankr. M.D. Fla. 1999) (against Providian based on post-discharge collection practices); In re Knox, 237 B.R. 687 (Bankr. N.D. Ill. 1999) (against Sunstar Acceptance for inflating secured claims); In re Lenior, 231 B.R. 662 (Bankr. N.D. Ill. 1999) (against GECC for inflating secured claims); In re Aiello, 231 B.R. 693 (Bankr. N.D. Ill. 1999), *aff'd* 257 B.R. 245 (N.D. Ill. 2000), *aff'd* 239 F.3d 876 (7th Cir. 2001) (against Providian Financial based on reaffirmation practices).

One would think it self-evident that a bankruptcy court could not exercise jurisdiction over damage claims that are property of another debtor in another case, if for no other reason than a recovery of damages on behalf of such a debtor would have no effect on the particular case pending in the forum court. Most courts have dismissed for lack of jurisdiction. *See* In re Nelson, 234 B.R. 528, 536-37 (Bankr. M.D. Fla. 1999); In re Lenior, 231 B.R. 662, 667-668 (Bankr. N.D. Ill. 1999); In re Knox, 237 B.R. 687, 693-94 (Bankr. N.D. Ill. 1999). On the other hand, perhaps a lawsuit that sought only *injunctive* relief on behalf of a class of debtors might not suffer the same jurisdictional defect. In re Watts, *supra.*

Other decisions are less clearheaded. The bankruptcy court in Noletto refused to dismiss

for lack of jurisdiction. The court reasoned that the class action lawsuit was a proceeding "arising under" title 11, conferring jurisdiction under 28 U.S.C. § 1334(b), and that since the claims of all members of the putative class also arose under title 11, jurisdiction was proper in that court. 244 B.R. at 849. In In re Aiello, 231 B.R. 693, 702 (Bankr. N.D. Ill. 1999), *aff'd* 257 B.R. 245 (N.D. Ill. 2000), *aff'd* 239 F.3d 876 (7th Cir. 2001), the putative class representative sued Providian Financial Corp. to recover damages for automatic stay violations in coercing reaffirmation agreements. The bankruptcy court denied class certification but not on jurisdictional grounds, stating that the issues presented represented a core proceeding under 28 U.S.C. § 157 and that the exercise of jurisdiction was therefore proper, whether or not the claims of other class members are related to the class representative's bankruptcy case. The denial of class certification was affirmed by the district court and court of appeal, neither of which addressed the jurisdictional issue.

These holdings received an interesting treatment in In re Williams, 244 B.R. 858, 862 (S.D. Ga. 2000). That case involved alleged violations by Sears of the automatic stay and discharge injunction. The court acknowledged that the claims of other class members were not "related to" the putative class representative's case under section 1334(b), but did "arise under" title 11. The court then reasoned that section 1334(e) gives the district court *in rem* jurisdiction over all property of the estate, and that the litigation claims of the debtor were obviously property of the estate. Accordingly, since the same court would have jurisdiction over all of the class claims of debtors with cases within that district, the motion to dismiss for lack of jurisdiction was denied as to such class members. By the same token, the court could not exercise jurisdiction over the claims of debtors in cases in other districts, and dismissed as to such claims.

It is unclear why such legal acrobatics are necessary. Injunctive relief and damages for debtors injured by violations of the automatic stay and discharge injunction can and have been successfully prosecuted in Article III courts where jurisdiction is unproblematic. For instance,

class plaintiffs recovered millions of dollars from Sears in class litigation in the Massachusetts district court. Efforts to seek such relief in a single bankruptcy case on behalf of a class of debtors in other bankruptcy cases smack of forum shopping, in the hope or expectation that a bankruptcy judge familiar with the legal terrain, and who may be on record as criticizing the disputed practices, will be favorably disposed to the claims.

F. The Class Action Settlement qua Third Party Injunction

Another interesting application of class action procedures in bankruptcy took place in the chapter 7 bankruptcy case of the former prominent accounting firm Pannell Kerr Forster.[3] In the case of In re Madison Associates, 183 B.R. 206 (Bankr. C.D.Cal. 1995), the court certified a binding class of all estate creditors, under Bankruptcy Rule 7023(b)(1)(B), with the class representatives to serve as co-plaintiffs with the debtor and creditors' committee. While the Madison decision is noteworthy for its endorsement of deficiency actions by partnership debtors in chapter 11 cases, for which the jingle rule of Bankruptcy Code § 723 is unavailable, its relevance here is its recognition of the class action as a vehicle to accomplish post-confirmation injunctive relief and the functional equivalent of third party releases.

A release of creditor claims against third parties is sometimes an essential component of a plan of reorganization, particularly where the plan relies in part on contributions by such parties. This has been achieved by enjoining post-confirmation creditor suits against such creditors. That tactic, however, has been approved only by certain courts of appeal. *See, e.g.*, In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285 (2d Cir. 1992), *cert. dismissed*, 506 U.S. 1088, 113 S.Ct. 1070 (1993); In re Johns-Manville Corp., 837 F.2d 89 (2d Cir. 1988), *cert. denied*, 488 U.S. 868, 109 S.Ct. 176 (1988); In re A.H. Robins Co., Inc., 880 F.2d 694 (4th Cir. 1986), *cert. denied*, 493 U.S. 959, 110 S.Ct. 379 (1989); In re A.H. Robins Company, 880 F.2d 694 (4th Cir. 1989) cert. denied, 493 U.S. 959, 110 S.Ct. 376, 107 L.Ed.2d 362 (1989); MacArthur v. Johns

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[3]/ This discussion lifts freely from the article by my partners Andrew Caine and Thomsen Young, "Need Post-Confirmation Injunctive Relief: Get Some Class," published in the November 1995 ABI Journal.

Manville Corp. (In re Johns Manville), 837 F.2d 89 (2d Cir. 1988). *See also* In re Continental Airlines, 203 F.3d 203 (3d Cir. 2000) (denying injunction on facts but leaving open possibility that such relief may be permitted); Matter of Specialty Equipment Co. Inc., 3 F.3d 1043, 1047 (7th Cir. 1993) (expressing support for flexible standard).

Some courts have rejected this practice as violating Bankruptcy Code § 524(e), which provides that a debtor's discharge does not release the liability of any other entity.[4] In re American Hardwoods, 885 F.2d 621 (9th Cir. 1989); Underhill v. Royal, 769 F.2d 1426 (9th Cir. 1985); In re Lowenschuss, 67 F.3d 1394 (9th Cir. 1995) *cert. denied*, 116 S.Ct. 2497 (1996). *See also* In re Zale Corp., 62 F.3d 746 (5th Cir. 1995) (endorsing American Hardwoods); In re Western Real Estate Fund Inc., 922 F.2d 592 (10th Cir. 1990) (adopting American Hardwoods).

In Madison, the debtor was an accounting general partnership that had ceased operations. A primary asset was the debtor's deficiency/contribution claims against its 330 or so former partners. As the estate's assets were estimated at $8 million and liabilities exceeded $300 million (primarily malpractice claims), it was clear that an insurmountable deficiency would result. A confirmable plan required substantial voluntary contributions from the former partners, who were understandably unwilling to contribute absent post-confirmation protection from state court actions by partnership creditors, based on the partners' general partner liability. Such protection was essential to recovering any value on the acquisition notes and deficiency claims. This value would be lost if the case converted to chapter 7, in which case mass partner bankruptcies were expected. As the case was filed in Los Angeles, post-confirmation protection for the non-debtor partners appeared unlikely based on American Hardwoods.

The Madison court felt bound to follow American Hardwoods and thus denied the debtor's request for Robins/Manville post-confirmation injunctive relief under Sec. 105. However, the court embraced a novel solution utilizing Rule 23. The debtor and the committee brought a deficiency action against all of the debtor's former partners under Bankruptcy Code §§

[4]/ Except in asbestos cases, in which the Bankruptcy Code permits injunctions on prescribed conditions. 11 U.S.C. § 524(g).

541 and 544 and applicable state partnership law. Two members of the committee were named as co-plaintiffs, as representatives of a proposed class of the more than 1,000 creditors of the estate. Certification of a binding class under Rule 23(b)(1) was crucial to confirmation of the debtor's proposed plan, for it would bind all partnership creditors to the actions of the class representatives, who clearly intended to settle with the former partners following certification.

The court certified the class under Rule 23(b)(1)(B), based on the "limited fund" available to meet the claims of the proposed class of creditors. Individual prosecutions would inequitably distribute the limited funds to the swiftest and strongest of the creditors, and would, as a practical matter, be dispositive of the interests of the members of the class. *But see* In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285 (2d Cir. 1992) in which the Second Circuit explained that the "limited fund" principle underlying Rule 23(b)(1)(B) was intended to address the equitable dilemma posed by the "race to the courthouse" of individual litigants, and should not typically apply in bankruptcy where that concern was not present. Id. at 292.

Notably, in Madison there was no opportunity for class members to opt out of the class, which was certified under Rule 23(b)(1)(B). Only members of a class certified under Rule 23(b)(3) are entitled to request exclusion under Rule 23. Because there was no opt-out, the remedy of partnership creditors would thus be limited to recovery on their claims against the estate, including in any funds generated by the deficiency action. Accordingly, the contributing partners effectively obtained the post-confirmation relief they had required as a condition of their payments.

A leading authority on class actions concurs with this approach: Noting that the purpose of certification on a "limited fund" basis is to facilitate an equitable distribution of such funds, "[w]hen the impairment tests of Rule 23(b)(1)(B) have been strictly applied and the court certifies a class under that section, permitting class members then to opt out of such a class action would defeat its essential purpose." 6 Conte & Newberg, Newberg on Class Actions § 20:14 (4th Ed. 2002). Noting that creditors may not opt of bankruptcy cases, it further states:

"Rule 23 class certification in the bankruptcy context does not change this result." Id. While the same authority opines that a Rule 23(b)(1)(B) class "should not be certified for general litigation purposes," it proceeds to recommend certification of such a class, where appropriate, for settlement purposes in order to facilitate a binding settlement. Id. at § 20:30.

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FUTURE CLAIMANT TRUSTS AND "CHANNELING INJUNCTIONS" TO RESOLVE MASS TORT ENVIRONMENTAL LIABILITY IN BANKRUPTCY: THE MET-COIL MODEL*

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INTRODUCTION

This Article describes a new legal model for resolving mass tort claims against a company as a result of environmental contamination. The new model involves the use of a future claimant trust and a channeling injunction in a chapter 11 bankruptcy proceeding. The model, adapted from the commonly-employed 11 U.S.C. § 524(g) asbestos future claimant trust, offers significant advantages to companies and claimants in other mass tort situations in which the universe of future claims is uncertain but potentially overwhelming.

After spending more than $18 million on a rash of personal injury litigation brought by residents in the neighborhoods surrounding one of its facilities (the "Lockformer Site") where trichloroethylene ("TCE") was spilled onto the soil, allegedly contaminating the groundwater supply in the area,[1] Met-Coil Systems Corporation ("Met-Coil" or the "Debtor") filed for bankruptcy, with numerous lawsuits pending. After less than a year of negotiations among the Debtor, its parent, Mestek, Inc. ("Mestek"), and a court-appointed legal

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* This Article was written with the assistance of Sean T. Greecher, an associate at Young Conaway Stargatt & Taylor, LLP. Much of the factual information about the *Met-Coil* case appearing in this Article consists of direct and unquoted portions of the record, including the Disclosure Statement *infra* at note 1, the Confirmation Order *infra* at note 3, and the affidavit of Eric D. Green *infra* at note 5.

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[1] Fourth Amended Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for the Chapter 11 Plan of Reorganization Proposed by Met-Coil Systems Corp. and Mestek, Inc., as Co-Proponents, at 18, *In re* Met-Coil Sys. Corp., No. 03-12676 (Bankr. D. Del. June 22, 2004) (No. 967) [hereinafter Disclosure Statement].

representative for future claimants, Eric D. Green (the "FCR"),[2] the Bankruptcy Court for the District of Delaware approved Met-Coil's plan of reorganization (the "Plan").[3] The Plan provided funding for the clean-up of the contaminated area, the costs associated with connecting area residents to a municipal water supply,[4] and a personal injury trust (the "TCE PI Trust") to compensate future personal injury claimants who, over the next forty-five years, allege their exposure to TCE released from the Debtor's facility is the cause of cancer or other diseases.[5]

The Plan also included as its keystone a "channeling injunction," which protects the reorganized Met-Coil, Mestek, and other related parties (namely insurers) from personal injury liability arising from the TCE allegedly emanating from the Lockformer Site.[6] The bankruptcy court issued Met-Coil's channeling injunction pursuant to 11 U.S.C. § 105(a), which authorizes the court to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the U.S. Bankruptcy Code ("Code").[7]

The Plan and TCE PI Trust were modeled after the plans of reorganization and future claimant trusts first developed in the context of asbestos claims[8] and other mass torts.[9] The Met-Coil Plan adapted these earlier models to create a

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[2] Met-Coil filed its voluntary petition for relief under chapter 11 on August 26, 2003. *In re* Met-Coil Sys. Corp., No. 03-12676 (Bankr. D. Del. Aug. 26, 2003) (No. 1). Eric Green was appointed on October 20, 2003. Disclosure Statement, *supra* note 1, at 26.

[3] Findings of Fact, Conclusions of Law and Order Confirming the Fourth Amended Chapter 11 Plan of Reorganization for Met-Coil Systems Corp., *In re* Met-Coil Sys. Corp., No. 03-12676 (Bankr. D. Del. Aug. 16, 2004) (No. 1216) [hereinafter Confirmation Order].

[4] Disclosure Statement, *supra* note 1, at 83.

[5] *See* Affidavit of Eric D. Green in Support of Confirmation of Fourth Amended Chapter 11 Plan of Reorganization Proposed by Met-Coil Systems Corp. and Mestek, Inc., as Co-Proponents, at 50, *In re* Met-Coil Sys. Corp., No. 03-12676 (Bankr. D. Del. July 23, 2004) (No. 1132) [hereinafter Green Affidavit]. The TCE PI Trust is funded by a collateralized stream of cash payments, with an aggregate present value of no less than $24,500,000, to satisfy the claims of holders of future TCE-related personal injury claims as well as the costs of establishing the trust, and an additional $6,510,000 to satisfy all personal injury claims for which settlements were reached either prior to or during the pendency of the bankruptcy case. *Id.* at 16.

[6] *See* Disclosure Statement, *supra* note 1, at 54.

[7] 11 U.S.C. § 105(a) (2000).

[8] *See, e.g., In re* Johns-Manville Corp., 68 B.R. 618, 626 (Bankr. S.D.N.Y. 1986) (holding the bankruptcy court had the authority to issue, as part of the reorganization plan, a channeling injunction that diverted all asbestos-related claims away from the debtor to trusts set up to compensate these claimants), *rev'd on other grounds*, 78 B.R. 497 (S.D.N.Y. 1987).

[9] *See, e.g.*, Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694 (4th Cir. 1989) (approving a reorganization plan containing a channeling injunction that created a future claimant trust for personal injury claims resulting from use of Dalkon Shield intra-uterine devices ("IUDs")).

future claimant trust that fits the problem of environmental contamination.[10] The Met-Coil Plan provides a viable and equitable model for dealing with environmental contamination through bankruptcy.

In discussing the Met-Coil model, this Article will: (1) outline the process by which the Met-Coil Plan was developed, (2) briefly discuss the history of future claimant trusts in bankruptcy on which the Met-Coil plan and trust was based, (3) examine subsequent opinions that have shaped and will continue to shape the conduct of mass-tort bankruptcies, and (4) discuss the potential future applications of future claimant trusts in bankruptcy.

I. "TOXIC TORT BANKRUPTCY"—AN OVERVIEW OF THE PROCESS

A. Liabilities Driving the Decision to File for Bankruptcy

In 1976, Congress passed the Toxic Substances Control Act ("TSCA"),[11] which authorizes the Environmental Protection Agency ("EPA") to catalog "chemical substances and mixtures which present an unreasonable risk of injury to health or the environment, and to take action with respect to chemical substances and mixtures which are imminent hazards."[12] The EPA has cataloged approximately 75,000 chemicals that fall into the category of posing an "imminent hazard" to the environment.[13] These industrial chemicals are generally used for a wide variety of purposes.[14] Thirty years after the passage of TSCA, however, very little is known about the environmental risks of the vast majority of these chemicals.[15]

For companies that used potentially toxic chemicals, the risk those chemicals will cause significant personal injury is a costly one. As further scientific inquiry and epidemiological study reveals the effects of exposure to these chemicals, the likelihood that injured individuals will seek recovery from the companies increases. Toxic tort litigation, and the looming threat of future litigation, can cripple a business. The costs of settlements and jury awards, not

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[10] Green Affidavit, *supra* note 5, at 17–22.

[11] 15 U.S.C. §§ 2601–2629 (2000).

[12] *Id.* § 2 601(b)(2).

[13] EPA, What is the TSCA Chemical Substance Inventory, http://www.epa.gov/oppt/newchems/pubs/invntory.htm (last visited Nov. 29, 2005).

[14] *Id.*

[15] ROBERT V. PERCIVAL ET AL. ENVIRONMENTAL REGULATION: LAW, SCIENCE, AND POLICY 374–75 (3d ed. 2000).

to mention the accompanying transaction and litigation costs, can be exponential.[16] Equally challenging in assessing potential future mass-tort or other environmental liability is identifying who the individual claimants may be and when each claimant may manifest injuries. Both issues may factor into a company's calculation and financial reporting of the present value of such litigation liabilities.

B. The Bankruptcy Process—Resolving Future Claims Through Equitable Channeling Injunctions—In re Johns-Manville

Bankruptcy provides a means by which companies saddled with potential future liabilities—liabilities that by their nature are not capable of being known with any certainty—can address these liabilities in a comprehensive and equitable manner and obtain a "fresh start."[17] Chapter 11 reorganizations are generally preferable to chapter 7 liquidations,[18] especially from the perspective of future claimants in mass tort contexts.[19] To provide a true "fresh start," however, the bankruptcy process must provide companies with a means to create a plan that resolves all of their current liability and provides some assurance that no future liability is carried past the conclusion of the bankruptcy case.

To encourage capital contributions into a reorganized enterprise, investors must be confidence their financial commitments will not be threatened by future liability arising from prepetition activity. Without a quantifiable and fixed measure of liability, principals and investors in the reorganized enterprise

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[16] *See, e.g., In re* UNR Indus., 725 F.2d 1111, 1113 (7th Cir. 1984) (noting UNR, one of the first companies to file for bankruptcy based on asbestos liabilities, was a defendant in over 17,000 asbestos suits and expected to be sued by anywhere from 30,000 to 120,000 new asbestos victims).

[17] *See* Grogan v. Garner, 498 U.S. 279, 286 (1991) ("[a] central purpose of the [Bankruptcy] Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.") (citations omitted).

[18] *See* Bonner Mall P'ship v. U.S. Bancorp Mortgage Co. (*In re* Bonner Mall P'ship), 2 F.3d 899, 916 (9th Cir. 1993).

> [W]hile the protection of creditors' interests is an important purpose under Chapter 11, the Supreme Court has made clear that successful debtor reorganization and maximization of the value of the estate are the primary purposes. Chapter 11 is designed to avoid liquidations under Chapter 7, since liquidations may have a negative impact on jobs, suppliers of the business, and the economy as a whole.

Id.(citations omitted); *see also* Toibb v. Radloff, 501 U.S. 157, 163–64 (1991); United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983).

[19] *In re* Asbestos Prods. Liab. Litig. (No. VI), 771 F. Supp. 415, 418–19 (J.P.M.L. 1991).

would continue to operate under the specter of future claims destroying the company, and therefore would be reluctant to contribute to a reorganized enterprise or a settlement trust for future claimants.[20]

The business objective of discharging liabilities for future claims, however, can conflict with notions of due process.[21] A party holding a claim against a debtor on account of trade receivables, for example, has an opportunity to fully participate in the bankruptcy process, and if the debtor attempts to discharge the creditor's claim, the creditor must be given notice.[22] Future claims are unlike existing claims because the debtor is unable to give the future claimants notice; obviously, the identity of the future claimants is unknown. Indeed, the discharge provisions of the Code do not operate to resolve liabilities that have yet to ripen into a "claim" (under state law).[23]

In the context of a bankruptcy reorganization involving future claims, were the debtor to simply continue operations outside of bankruptcy and defend itself against litigation as it arose, later tort claimants risk litigating against a company with depleted or nonexistent resources. Similarly, were a company to liquidate its assets in bankruptcy, individuals with no present claims against the debtor at the time of liquidation might have no recourse. Thus, reorganization strikes an equitable balance between current and future claimants by eliminating the inequity that results from a piecemeal dismemberment through inexorable litigation or outright liquidation of a company, processes which favor earlier claimants over later claimants.[24]

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[20] *See, e.g., In re* Am. Family Enters., 256 B.R. 377, 408 (D.N.J. 2000) (noting without a channeling injunction, creditors would face a "serious risk" of no recovery).

[21] *See* Laura B. Bartell, *Due Process for the Unknown Future Claim in Bankruptcy—Is This Notice Really Necessary?*, 78 AM. BANKR. L.J. 339 (2004).

[22] FED. R. BANKR. P. 3007.

[23] To determine whether a potential liability is a claim, various jurisdictions have used various tests, including: (1) the "conduct test" (*see, e.g.*, Grady v. A.H. Robins Co. (*In re* A.H. Robins Co.), 839 F.2d 198, 201 (4th Cir. 1988) (claims arise based on time when acts giving rise to alleged liability were performed)); (2) the "preconfirmation relationship test" (*see* Epstien v. Official Comm. Of Unsecured Creditors (*In re* Piper Aircraft Corp.), 58 F.3d 1573, 1578 (11th Cir. 1995) (recognition of claim requires prepetition breach and preconfirmation contact, privity, or other relationship between debtor and creditor)); (3) the "prepetition relationship test" (*see, e.g.*, United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997, 1000 (2d Cir. 1991) (holding that recognition of claim requires prepetition act or omission and prepetition contact privity or other relationship)); and (4) the "accrued state law claim test" (*see In re* M. Frenville Co., 744 F.2d 332, 337 (3d Cir. 1984) (holding a claim is not cognizable in bankruptcy if not yet cognizable under state law)).

[24] Bankruptcy reorganization serves important policy goals in the area of future claims because

> [i]t stops the 'race to the courthouse,' where the early victims whose injuries have manifested themselves are paid in full while later claimants receive nothing after all the debtor's assets have been exhausted. Reorganization also preserves the going concern value of the business—

The competing goals of (1) providing companies with a comprehensive resolution of their liabilities and (2) protecting the interests of future claimants can both be satisfied by an injunction that channels future claims not subject to discharge away from the debtor (and potentially the debtor's affiliates and insurers) into a trust that resolves the claims. This mechanism of establishing a trust for future claimants, referred to as a "channeling injunction," was first employed in the context of bankruptcy proceedings in 1986 in the *In re Johns-Manville Corp.*[25]

Johns-Manville expected thousands of future victims of asbestos exposure would have claims far exceeding the estimated net worth of the existing company.[26] The Bankruptcy Court for the Southern District of New York was determined to treat both present and future asbestos claims in the same manner.[27] By establishing two future claimant trusts, the *Johns-Manville* plan sought to compensate more potential victims than would have been possible had the company not declared bankruptcy.[28] Through the use of channeling injunctions, the *Johns-Manville* plan preserved a healthy, functioning company, which in turn provided additional value for the trusts (which owned the stock of the reorganized company) and future claimants.[29]

To preserve the value of the reorganized company, the *Johns-Manville* court issued an injunction that "effectively channel[ed] all asbestos related claims and obligations away from the reorganized entity and target[ed] it towards the [trusts] for resolution."[30] The *Johns-Manville* court relied on its equitable powers for authority to issue the channeling injunction[31] and

> principally its ability to generate a cash flow from which future claims or cleanup claims may continue to be paid as they arise.

Richard L. Epling, *Separate Classification of Future Contingent and Unliquidated Claims in Chapter 11*, 6 BANKR. DEV. J. 173, 173–74 (1989).

[25] *In re* Johns-Manville Corp., 68 B.R. 618, 626 (Bankr. S.D.N.Y. 1986).

[26] *Id.* at 636.

[27] *Id.* at 628.

> From the outset, it should be noted that in a very real sense, both from the point of view of the Debtor and from that of the asbestos victims, a distinction between 'present' and 'future' victims is, at best, nominal. The Trust does not make this nominal distinction and is designed to satisfy the claims of all victims, whenever their disease manifests.

Id.

[28] *Id.* at 621–22.

[29] *Id.* at 635.

[30] *Id.* at 624.

[31] *Id.* at 625 (citing Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., Rock Island & Pac. Ry. Co., 294 U.S. 648 (1935)).

specifically recognized that § 105 of the Code "codified" the court's "equitable power" and "allow[ed] a bankruptcy court to enjoin proceedings in other courts to ensure the efficient administration of an estate."[32]

Apart from the question of statutory authority, the *Johns-Manville* court also grappled with due process concerns arising from the plan's proposed treatment of future claimants.[33] Because the plan limited suits against the reorganized debtor by those who would discover, post-confirmation, that they had developed an asbestos-related illness, objectors argued that the injunction would "unconstitutionally bind future claimants to an impairment of their rights without appropriate notice."[34] The court rejected this argument, writing that "[d]ue process . . . does not and has never, mandated personal, actual notice"[35] but instead requires only notice "reasonably calculated" to "apprise interested parties of the pendency of the action."[36] The *Johns-Manville* court's ruling recognizes the inherent limitations in providing notice under circumstances where claimants whose rights may be affected are unknown and unknowable while additionally recognizing the general benefits (both to the debtor company and to the future claimants) of resolving future claims through the bankruptcy process.

In an effort to safeguard the rights of future claimants, the *Johns-Manville* court appointed a legal representative for future claimants.[37] The court endowed the future claimants' representative with "the full panoply of statutory rights and duties of representation available to an official committee under the Code."[38] The court noted "binding unknown parties in interest to the outcome of judicial procedures in which they have been represented by a trustee [or] legal representative . . . is not a novel phenomenon in the law."[39] In fact, the court found that the "goal of the Plan and the purpose of the Injunction [was] to preserve the rights and remedies of those parties, who by

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[32] *Id.* at 625. The authority the *Johns-Manville* court adduced from § 105(a) to issue channeling injunctions was subsequently codified in § 524(g) of the Code for asbestos-related bankruptcy cases. *See* 11 U.S.C. § 524(g) (2000).

[33] *In re Johns-Manville*, 68 B.R. at 626.

[34] *Id.*

[35] *Id.* The debtor had undertaken "an extensive campaign designed to provide the maximum amount of publicity" which included "national television and radio advertisements, newspaper advertisements in the six leading U.S. and Canadian newspapers and in the largest circulation daily newspaper in each state, the District of Columbia and each Canadian province." *Id.*

[36] *Id.* at 626 (quoting Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950)).

[37] *Id.* at 626–27.

[38] *Id.*

[39] *Id.* at 626–27.

an accident of their disease cannot even speak in their own interest."[40] The court thus found due process was better served by confirming the plan and issuing the channeling injunction because disallowing the plan and injunction on the basis of due process concerns would "deny asbestos victims justice and equity" by preventing any future claims from being compensated at all.[41]

C. The Future Claimants' Representative—Fiduciary Duties

As illustrated by the *Johns-Manville* reorganization, because a channeling injunction dramatically impacts the rights of future mass-tort claimants, the appointment of a representative to protect the interests of future claimants is an essential component of resolving future claims in the bankruptcy process.[42] In *Met-Coil*, the FCR appointed by the bankruptcy court[43] primarily focused on determining whether the Plan, trust agreement, and trust distribution procedures would treat holders of future TCE claims fairly and equitably.[44] The FCR's negotiations with the Debtor and Mestek resulted in a Plan the bankruptcy court deemed fair and equitable in its treatment of future claimants and representative of a reasonable resolution of the Debtor's and its affiliates' liabilities for current and future TCE-related personal injury claims.[45] The bankruptcy court also found the TCE channeling injunction was necessary to ensure sufficient funding of the TCE PI Trust, which allowed for the fair and equitable treatment of future claimants.[46]

Before bringing the Plan before the bankruptcy court for confirmation, the FCR considered, among other things, the following: the number of future claims expected to be asserted against Met-Coil, the expected timing of such claims, the appropriate method by which future claims would be paid through a settlement trust, the level of funding required to satisfy all future claims, and whether the trust structure as a whole would inure to the benefit of the class of future claimants.[47]

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[40] *Id.*

[41] *Id.*

[42] *See id.* at 618; *see, e.g.*, *In re* Combustion Eng'g, Inc., 391 F.3d 190, 204 n.8 (3d Cir. 2004). When a trust is established through bankruptcy in favor of future claimants, the Code requires "the court appoint[] a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands" against the trust. 11 U.S.C. § 524(g)(4)(B)(i) (2000).

[43] Order Authorizing the Appointment of Eric D. Green as Legal Representative for Future Claimants, *In re* Met-Coil Sys. Corp., No. 03-12676 (Bankr. D. Del. Oct. 20, 2003) (No. 205).

[44] Green Affidavit, *supra* note 5, at 6.

[45] *See* Confirmation Order, *supra* note 3, at 30.

[46] *Id.*

[47] *See infra* notes 48–102 and accompanying text.

D. Identifying the Potential Universe of Claims

To fulfill its responsibilities as a fiduciary to future claimants, a future claimants' representative generally must undertake a substantial amount of due diligence to assess the likelihood, number, and value of potential future claims.[48] In the context of negotiating an appropriate level of funding to satisfy future claims in mass-tort bankruptcies, the future claimants' representative must draw from a number of different sources to reach an estimate of the final projection of future liability. In *Met-Coil*, the FCR employed experts in hydrology, epidemiology, toxicology, and econometrics to calculate an appropriate level of funding for the TCE PI Trust.[49]

In assessing the likelihood and value of future TCE-related personal injury litigation, the FCR considered, among other things, the levels of TCE detected in the vicinity of the Lockformer Site, the potential health effects of exposure to TCE, the size of the potentially affected population, the Debtor's and Mestek's history with TCE-related personal injury claims, and information on settlements and judgments involving TCE claims nationwide.[50] The FCR also examined the Debtor's and Mestek's ability to satisfy future TCE-related personal injury claims.[51]

1. Creating a "Footprint" of Contamination

As a first step in determining the number of potential future TCE claims, the FCR directed a hydrologist, Dr. Jonathan F. Sykes, to map out a "footprint" of the contamination released in the vicinity of the Lockformer Site to determine where the TCE contaminants might have migrated.[52] Dr. Sykes' analysis was based on samples from wells around the Lockformer Site, geological characteristics of the area, and a review of water usage records.[53] Dr. Sykes used this data to determine whether significant draws had been made from the surrounding aquifer, to plot the general migration of the TCE

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[48] *Id.*; *see also* Application of Met-Coil Systems Corp. Pursuant to 11 U.S.C. §§ 105 and 1109 for the Appointment of Eric D. Green as Legal Representative for Future Claimants, *In re* Met-Coil Sys. Corp., No. 03-12676 (Bankr. D. Del. Sept. 22, 2003) (No. 110).

[49] *See* Confirmation Order, *supra* note 3, at 22.

[50] *Id.*

[51] *See* Green Affidavit, *supra* note 5, at 6.

[52] *Id.* at 8.

[53] *Id.*

contaminants in the groundwater from the date of first contamination to the present, and to estimate the levels of contamination in the affected locations.[54]

Upon determining whether and when certain areas might have been contaminated, Dr. Sykes identified a geographic area where TCE-contaminated groundwater might be present (defined in the Plan as the "Designated Area") and identified the level of exposure at various points within the Designated Area.[55] Dr. Sykes' analysis circumscribed the area where TCE contamination likely had already spread and could potentially spread in the future, which served as one of the cornerstones for the FCR's evaluation of the appropriate funding levels for the trust.[56]

2. Calculating the Effects of TCE Exposure

The next step was to determine how the observed levels of TCE in the Designated Area could affect the health of the individuals exposed to it.[57] Based on estimated well water contamination levels in the Designated Area, Dr. Jeffrey Mandel and Dr. Abby Li of Exponent determined the levels of TCE to which humans in the Designated Area might have been exposed.[58] They then assessed how these levels of exposure might affect the incidences of cancerous and non-cancerous diseases in the exposed population.[59]

Because it is imperative a future claimant trust be sufficiently funded, Exponent made conservative assumptions.[60] As a result, the FCR could be confident the funding levels provided to the trust would be sufficient to protect the enterprise from collateral attack on the basis of insufficient funding.[61]

Relying on its own TCE-exposure level assessment, Exponent estimated the increased risk to the exposed population of developing non-cancerous and

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[54] *Id.*

[55] *Id.*

[56] *Id*

[57] *Id.* at 8–9.

[58] *Id.* Exponent is an engineering and scientific consulting firm. Expnonent, Inc., http://www.exponent.com (last visited Dec. 3, 2005).

[59] *See* Green Affidavit, supra note 5, at 8–9. Exponent considered water, air, and soil as potential pathways of exposure to humans. *Id.* at 9.

[60] *Id.*

[61] *Id.* For example, Exponent assumed the level of TCE existing at each tested source within the Designated Area was the measurement corresponding to the 95% upper confidence limit of the mean TCE measurement for each source. *Id.* This means statistically there is only a 2.5% likelihood that the true mean measurement would exceed the measurement actually used by Exponent in its calculations. *Id.*

cancerous diseases.[62] For non-cancer risk, Exponent determined threshold levels of concern by examining reference doses[63] proposed by the EPA along with recent scientific literature. Exponent determined the levels of exposure to TCE detected in the Designated Area were well below the threshold levels[64] necessary to cause any increased risk of non-cancerous diseases.[65]

Although the excess risk of cancer resulting from TCE exposure in the Designated Area was determined to be either non-existent or very low,[66] Professor Green asked Exponent to determine the specific cancers associated with TCE exposure in published scientific literature.[67] His reason was twofold. First, the quantum of proof necessary in a courtroom may not be the same as what is necessary to demonstrate causation to a peer-reviewed medical journal.[68] So long as a claimant can provide sufficient evidence that there *may* be a correlation between the defendant's actions and the claimant's injury, that evidence may be sufficient for the case to survive a motion for summary judgment and for a fact finder to rule in favor of the claimant.[69] Second, while a number of scientific studies consider the connection between TCE exposure and cancer in humans, the science is still relatively nascent.[70] For example, there was very little, if any, scientific literature forty years ago suggesting the dangers of asbestos exposure.[71] Today, the dangers and potential effects of asbestos exposure are nearly universally agreed upon.

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[62] *Id.*

[63] A reference dose is the level of daily intake that is acceptable without causing an appreciable increased risk of illness. EPA, IRIS Glossary of Terms, http://www.epa.gov/iris/gloss8.htm (last visited Nov. 28, 2005).

[64] A threshold level is the average concentration beyond which human health may likely be threatened. *Id.*

[65] *See* Green Affidavit, *supra* note 5, at 9–10.

[66] *Id.* at 9–10.

[67] *Id.* at 10.

[68] *See* Rosen v. Ciba-Geigy Corp., 78 F.3d 316, 318 (7th Cir. 1996) ("When scientists testify in court [the legal system requires that] they adhere to the same standards of intellectual rigor that are demanded in their professional work. If they do, their evidence (provided of course that it is relevant to some issue in the case) is admissible even if the particular methods they have used in arriving at their opinion are not yet accepted as canonical in their branch of the scientific community.") (citations omitted).

[69] Green Affidavit, *supra* note 5, at 10. This reality of litigation was certainly not unfamiliar to Met-Coil. Met-Coil and Mestek had reached settlements with certain claimants and had obtained unfavorable trial verdicts against other claimants who alleged injuries relating to TCE exposure, even though the available scientific literature did not necessarily support the validity of those claims. Confirmation Order, *supra* note 3.

[70] *Trichloroethylene* CAS # 79-01-6 (Agency for Toxic Substances & Diseases Regisrty, Atlanta, Ga., July 2003), *available at* http://atsdr1.atsdr.cdc.gov/tfacts19.pdf.tfacts19.pdf.

[71] The first lawsuit relating to asbestos exposure is believed to have been filed in 1966. Asbestos & Libby Health, History, http://www.umt.edu/LibbyHealth/introduction/background/asbestos_timeline.htm (last visited Dec. 1, 2005).

The trust had to address both of these concerns. Therefore, the FCR insisted upon estimating the value of claims based upon (1) the potential claimants could make a compelling case as a matter of law, even if not as a matter of science; and (2) the potential that future scientific studies would find future claimants' allegations of injury relating to TCE exposure were more compelling than scientific knowledge would suggest.[72] Based on the strength of Exponent's research findings,[73] the FCR identified specific cancers (the "Scheduled Diseases") for which claimants might be able to sustain a cause of action based on exposure to TCE.[74]

3. *Estimating the Population Within the Footprint that Might Become Diagnosed with a Scheduled Disease*

After identifying the types of injuries that could be associated with exposure to TCE, the FCR's team turned to identifying the size of the potentially exposed population and projecting the incidence of TCE-associated diseases likely to manifest in the exposed population.[75] Analysis Research Planning Corporation ("ARPC"), retained by the FCR to serve as econometricians and consultants, provided the FCR with analysis of the timing and volume of future claims that could be expected in personal injury actions.[76] ARPC estimated the number of individuals in the Designated Area who might eventually be diagnosed with one of the Scheduled Diseases.[77] ARPC used Dr. Sykes' footprint of estimated TCE contamination to develop a database of residential properties within the Designated Area where residents may have been exposed to TCE.[78]

ARPC estimated the number of individuals who potentially resided in the residential properties that fell within the Designated Area during the periods of TCE contamination.[79] For each of the properties in the database, ARPC

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[72] *See* Green Affidavit, *supra* note 5, at 8.

[73] Exponent explained, while the published scientific literature does not conclusively support TCE as being causally related to any type of cancer, some studies found statistical associations between certain cancers and TCE exposure.

[74] Green Affidavit, *supra* note 5, at 10.

[75] *Id.*

[76] *Id.* at 12.

[77] *Id.*

[78] *Id.* at 10. A property was included in this analysis if it met all three of the following criteria: (1) the property was within the Designated Area, (2) the property was situated in an area where some of the residents used private residential wells for drinking water, and (3) the property was listed as residential or leased on the DuPage County Assessor's database. *Id.*

[79] *Id.* at 11–12.

provided an estimate of the number of individuals who resided in each household, based on current and historical data.[80] ARPC then estimated the number of individuals who moved into and out of the homes in the Designated Area (the "Turnover Rate"). By applying the Turnover Rate to the age-specific population in the Designated Area, ARPC was able to estimate how many residents in each age category moved into the Designated Area each year during the possible exposure time period.[81]

4. Calculating an Estimated Value of Future TCE-Related Claims

After identifying the potential universe of future claims, the FCR was faced with the task of determining an appropriate monetary value to satisfy them.[82] The FCR developed a range of values attempting to ensure a fair recovery for all potential future claimants.[83] To estimate the value of a future TCE-related claim, the FCR attempted to determine the potential recovery a claimant might expect to receive in a hypothetical tort action against the Debtor, taking into account the dose and duration of exposure for any given claimant.[84]

The FCR considered, among other things, relevant data from recent TCE-related judgments and the limited number of published settlements involving TCE-related cancer claims.[85] To "market check" the estimated values, the FCR contacted attorneys with significant experience in litigating similar mass-tort related personal injury actions for their opinion on the reasonableness of the estimated values.[86]

The FCR then considered the anticipated incidences of each of the Scheduled Diseases and the estimated value of these claims to arrive at the estimated aggregate liability of the TCE PI Trust with respect to the Scheduled Diseases.[87] This amount of estimated aggregate liability was slightly increased to allow for modest payments to individuals who claimed harm from their exposure to TCE from the Lockformer Site, but who have not been diagnosed

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[80] *Id.* at 11.

[81] *Id.* at 12.

[82] *Id.*

[83] *Id.*

[84] *Id.* at 12–13.

[85] *Id.* at 10.

[86] *Id.* at 13. The attorneys who participated in the survey were presented with a hypothetical case based on the facts of *Met-Coil*, and they were asked whether the estimated claim values being considered by the FCR for the Scheduled Diseases were reasonable and within the range of settlements for similar personal injury litigation. *Id.*

[87] *Id.*

with one of the Scheduled Diseases (the "Exposure-Only Claimants").[88] Allowing some recovery for Exposure-Only Claimants provides the TCE PI Trust with a means to avoid litigation over alleged injuries outside of the Scheduled Diseases and compensates claimants for tort claims relating to the fear of developing cancer.[89] Finally, the calculation was increased to include an estimated amount necessary for the costs of administering the TCE PI Trust, such as the cost of processing and litigating claims.[90]

E. Anticipating the Timing of Future Claims

In establishing the TCE PI Trust, the parties essentially reduced the value of anticipated claims over the next decades to present-day value.[91] To determine the present day funding requirements for the trust, the FCR needed to determine when future claims were likely to be asserted.[92] The FCR estimated the number of expected diagnoses for the exposed surviving population for the Level I and Level II Scheduled Diseases identified by Exponent.[93] Using data from the National Cancer Institute, ARPC identified the background cancer rates for the various Scheduled Diseases and applied the age-conditional probabilities of being diagnosed from 2003 (the year Met-Coil filed its bankruptcy case) through 2048 (the year the trust terminates) to estimate the expected number of occurrences of each Scheduled Disease.[94]

F. Negotiating Trust Funding Levels

In many cases, negotiations regarding an appropriate level of funding for a settlement trust are a battle of experts. When calculation of the trust's liability depends on the estimated value of future claims, many variables come into play: the number of people potentially affected by the toxic trigger, the extent

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[88] *Id.*

[89] *Id.* In Illinois, where the Lockformer Site is located, fear of a future harm is a legally cognizable tort. *See, e.g.*, Wetherill v. Univ. of Chi., 565 F. Supp. 1553, 1560 (N.D. Ill. 1983) (discussing the standards for proving a compensable injury based upon the fear of developing cancer in the future); Doe v. Nw. Univ., 682 N.E.2d 145, 151–52 (Ill. App. Ct. 1997) (discussing the standards for proving a compensable injury based upon the fear of contracting AIDS).

[90] Green Affidavit, *supra* note 5, at 13.

[91] *Id.* at 16.

[92] *Id.* at 12.

[93] *Id.*

[94] *Id.* ARPC excluded projected incidences of cancer arising prior to 2003 because any claims based on incidences of cancer would be subject to the bankruptcy deadline for filing proofs of claim; thus, only if individuals with pre-2003 cancer claims who filed a proof of claim that was allowed by the court would be eligible to recover from the TCE PI Trust. *Id.*

of the individuals' contact with the trigger, the expected severity of the illness contracted, and the propensity of such individuals to pursue legal action. Reasonable minds can substantially disagree as to the final estimate.

In *Met-Coil*, the FCR engaged in extensive negotiations with the Debtor and Mestek to determine the level of funding required by the TCE PI Trust to satisfy future TCE-related claims.[95] To ensure the trust would have adequate assets, the forecast of liability assumed that every claimant who could qualify for a payment under the trust's criteria would file claims against the TCE PI Trust.[96] However, experience with respect to claims filing patterns in similar contexts indicates something less than the maximum number of potential claimants actually file claims.[97]

The Debtor and Mestek engaged their own experts to analyze potential levels of exposure.[98] This process served as a "peer review" of sorts for the FCR experts' analysis, forcing the FCR's team to defend its analyses and assessments of potential exposure, damages, and liability.[99] During the negotiations between the FCR, the Debtor, and Mestek regarding the appropriate level of funding for the TCE PI Trust, the parties investigated and debated the conclusions underlying the FCR's estimate.[100] The conclusion included the actual size of the population exposed to TCE allegedly from the Lockformer Site, population turnover, epidemiological analysis, claiming behavior, and the amount at which the trust should value claims arising from various diseases.[101] In the end, the Debtor and Mestek agreed to contribute $24,500,000 to the trust.[102]

II. BEYOND *JOHNS-MANVILLE*: PRODUCTS LIABILITY MASS TORTS AND FUTURE CLAIMANT TRUSTS

Since 11 U.S.C. § 524(g) went into effect in 1996, courts have continued to issue channeling injunctions in cases not involving asbestos based on the broad

95 *See id.* at 14–15.
96 *Id.* at 15.
97 An example of these types of contexts is asbestos-related personal injury settlement trusts.
98 Green Affidavit, *supra* note 5, at 15.
99 *Id.*
100 *Id.*
101 *Id.*
102 *Id.* at 16.

grant of authority stemming from § 105(a).[103] For example, the *A.H. Robins* case established a trust for future claimants injured through the use of the Dalkon Shield IUD[104] and set the standard for future claimant trusts in non-asbestos products liability cases. The following sections discuss *A.H. Robins* and other cases in which bankruptcy courts relied upon § 105(a) for the channeling injunction and future claimant trust structure.

A. Establishing the "Future-ness" of Future Claims—In re Piper Aircraft

The primary consideration in determining whether a channeling injunction and trust are necessary to resolve a debtor's liability is whether the subject liability has ripened into a claim and is therefore subject to final resolution by a bankruptcy court's discharge.[105] With respect to personal injury or other tort-related liabilities, most courts adhere to the rule a liability is a claim[106] that can be dealt with and discharged through bankruptcy if the conduct giving rise to the liability occurred prepetition.[107] On the other hand, if the liability has not yet ripened into a claim, it cannot be discharged through the bankruptcy case.

The leading case on whether a liability is a claim or a future demand in bankruptcy is *Piper Aircraft*.[108] Prior to declaring bankruptcy, Piper was faced with product liability claims in connection with airplane crashes.[109] The company sought either to cut off future claims or funnel them into a trust through bankruptcy.[110] Piper attempted to achieve these goals by seeking a channeling injunction in its bankruptcy reorganization plan, likening its

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[103] The enactment of § 524(g) was not intended to modify the rights of bankruptcy courts to issue equitable injunctions pursuant to § 105(a). *See* 140 CONG. REC. H10752–01, H10766 (1994). Section 524(g) "is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan [of] reorganization .... The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved." *Id.*

[104] Menard-Sanford v. Mabey (*In re* A.H. Robins, Inc.), 880 F.2d 694, 700 (4th Cir. 1989).

[105] 11 U.S.C. § 1141(d)(1)(A) (2000) ("The confirmation of a plan ... discharges the debtor from any debt that arose before the date of such confirmation.")

[106] A claim is defined, in part, as any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or, unsecured." 11 U.S.C. § 101(5)(A).

[107] *See, e.g.*, Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1274–78 (5th Cir. 1994); *In re* UNR Indus., Inc., 20 F.3d 766, 770–71 (7th Cir. 1994); Cal. Dep't of Health Servs. v. Jensen (*In re* Jensen), 995 F.2d 925, 930–31 (9th Cir. 1993) (per curiam); *In re* Chi., Milwaukee, St. Paul & Pac. R.R. Co., 974 F.2d 775, 782–86 (7th Cir. 1992); United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997, 1005 (2d Cir. 1991); Grady v. A.H. Robins Co., 839 F.2d 198 (4th Cir. 1988). *Contra* Jones v. Chemetron Corp., 212 F.3d 199, 206 (3d Cir. 2000); Frenville v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332, 336–37 (3d Cir. 1984).

[108] *In re* Piper Aircraft Corp., 162 B.R. 619 (Bankr. S.D. Fla. 1994).

[109] *Id.* at 621.

[110] *Id.*

circumstances to those presented in the bankruptcy of A.H. Robins, the manufacturer of the Dalkon Shield IUD.[111] The *Piper* court rejected this analogy and declined to issue a channeling injunction with respect to future liability that, while likely to arise, remained purely hypothetical.[112] In the case of the Dalkon Shield IUD, all liability-producing events, other than the manifestation of symptoms, occurred prior to the petition date.[113] Although the total number of users and their identities were vague and undocumented, the information was estimated from sales and distribution records.[114] In the case of liability for any defect in Piper's airplanes, however, those contemplated as the "future claimants" had not even purchased tickets on the planes at the time of the bankruptcy petition and may even not have been born.[115] The court found "there is no way to identify who the victims will be or to identify any particular prepetition contact, exposure, impact, privity or other relationship between Piper and these potential claimants that will give rise to these future damages."[116] The court declined to consider the future victims of plane crashes within a future claimant trust even though the court said "some planes in the existing fleet of Piper aircraft will crash, and . . . there may be injuries, deaths and property damage as a result. . . . Piper, if it remain[ed] in existence, would be liable for some of [the] damages."[117]

As in *Piper*, the mass tort alleged against Met-Coil was one that did not lend itself to a discrete catalog of present personal injury claims; the total effect of the alleged wrongdoing likely would not be known until well into the future.[118] Unlike *Piper*, however, in *Met-Coil* there were specific acts that occurred prepetition (i.e., the discharge of TCE) that created specific prepetition contact, exposure, impact, privity, or other relationships between Met-Coil and potential claimants.[119] Indeed, in *Met-Coil*, all of the elements that gave rise to its TCE liability, other than the manifestation of an injury, existed prior to the initiation of the bankruptcy case.[120]

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111 *See id.* at 624.

112 *Id.* at 625.

113 A.H. Robins Co. v. Piccinin, 788 F.2d 994, 1011 (4th Cir. 1986). The products had been manufactured, distributed, purchased and used all before the filing of the bankruptcy petition. *Id.*

114 *In re Piper Aircraft*, 162 B.R. at 625.

115 *Id.*

116 *Id.* at 627.

117 *Id.*

118 *See* Green Affidavit, *supra* note 5, at 12.

119 *See* Disclosure Statement, *supra* note 1, at 16.

120 *See id.*

Environmental liability lends itself to resolution through bankruptcy because all of the acts that trigger potential liability generally occur prepetition; it is only the effect of acts that occur in the future. In fact, the environmental contamination often creates precisely the sort of prepetition relationship the *Piper* court contemplated.[121] Further, chapter 11 reorganization with a channeling injunction and trust structure presents the only viable means to bring finality to future demands arising from long-tailed environmental (and other) liabilities.[122] As the Supreme Court noted in *Ortiz v. Fibreboard Corp.*,[123] the potential to create a settlement trust to resolve both present and possible future claims does not exist under the class action model, and as such, class actions are not a viable option for "a fund and plan purporting to liquidate actual and potential [asbestos] tort claims."[124] The *Ortiz* court, however, left open the possibility of using bankruptcy as a mechanism.[125] The Met-Coil model implements the only available mechanism after *Ortiz* to accomplish this result.

B. Extension of § 105 Injunctions to Non-debtors—In re Dow Corning

The extension of the channeling injunction under Code § 105 to Met-Coil's parent, Mestek, and to certain insurers of the Debtor and Mestek, is a significant element of the Met-Coil Plan. The seminal case regarding the use of § 105 to extend protections to non-debtors in the context of mass tort bankruptcies is *Dow Corning*.[126] In *Dow Corning*, the court addressed the issue of whether § 105 provided sufficient authority for a bankruptcy court to enjoin claims against a non-debtor if the injunction facilitated a reorganization plan under chapter 11.[127] Under the plan proposed by Dow, a settlement trust fund was established from money contributed by Dow's products liability insurers, Dow's shareholders, and Dow's own cash reserves.[128] As a condition

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121 *In re Piper Aircraft*, 162 B.R. at 626 (citing United States v. LTV Corp. (*In re* Chateaugay Corp.), 944 F.2d 997, 1004–05 (2d Cir. 1991). In *In re Chateaugay Corp.*, the Second Circuit Court of Appeals held that the EPA had a dischargeable prepetition claim for cleanup costs that would not be incurred by the debtor until after confirmation of the debtor's chapter 11 plan because the cleanup costs concerned environmental hazards caused by the prepetition conduct of the debtor. 994 F.2d 997, 1005 (2d Cir. 1991).

122 FED. R. CIV. P. 23.

123 527 U.S. 815, 864 (1999).

124 *Id.* at 864.

125 See *id.* at 846.

126 Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648 (6th Cir. 2002).

127 *Id.* at 653.

128 *Id.* at 654.

to the funding by the third party insurers and shareholders, the plan released these parties from all existing and future liability on personal injury claims.[129] The court held while § 105(a) alone cannot serve as authority for granting a permanent injunction in favor of a non-debtor, such relief is available by reading §§ 1123(b)(6) and 105(a) in tandem.[130]

The *Dow Corning* court noted the issuance of such an injunction was appropriate only in "unusual circumstances."[131] Specifically, the court enunciated several factors used to determine whether an injunction for the benefit of third parties is appropriate:

> (1) There is an identity 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 the assets of the estate;
>
> (2) The non-debtor has contributed substantial assets to the reorganization;
>
> (3) The injunction is essential to 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.[132]

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[129] *Id.*

[130] *Id.* at 656–57. Section 1123(b)(6) states a plan of reorganization may include any "appropriate provision not inconsistent with the applicable provisions of [the bankruptcy code]." *Id.* at 656. The court in *Dow Corning* interpreted § 1123(b)(6) broadly as providing "the bankruptcy court, as a forum for resolving large and complex mass litigations, has substantial power to reorder creditor-debtor relations needed to achieve a successful reorganization." *Id.*

[131] *Id.* at 658 (citing SEC v. Drexel Burham Lambert Group, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 960 F.2d 285, 293 (2d Cir. 1992)); Manard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989); MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 93–94 (1988).

[132] *Id.* at 658 (citing *In re A.H. Robins*, 880 F.2d at 701–02; MacArthur, 837 F.2d at 92–94); Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 214 (3d Cir. 2000).

Met-Coil's bankruptcy and plan of reorganization met the "extraordinary circumstances" standards enunciated in *Dow Corning*.[133] There was an identity of interests between the Debtor and Mestek.[134] The debtor was wholly owned by Mestek and the only Mestek liability absolved under Met-Coil's plan was liability alleged as a result of Mestek's ownership in Met-Coil.[135] Mestek did not even own Met-Coil at the time the TCE contamination allegedly occurred at the Lockformer Site.[136] Similarly, the settling insurers, who were also protected by Met-Coil's channeling injunction, had an identity of interest with the debtor by virtue of their indemnity relationship.[137]

The contributions made by Mestek and the settling insurers provided significant value to the TCE PI Trust and sufficient capital to the reorganized entity such that the bankruptcy court determined the parties' contributions warranted the extension of the channeling injunction to those parties.[138] In addition, the court determined a reorganization of Met-Coil would not have been possible without the parties' contributions.[139] The Plan satisfied the remaining factors enunciated in *Dow Corning* through the establishment of the TCE PI Trust, which provided a mechanism (the "TCE PI Trust Distribution Procedures") to pay all TCE-related claims (the class of claims impacted by the channeling injunction).[140] Under the Plan and TCE PI Trust Distribution Procedures, claimants not satisfied with their treatment retain their right to independently sue the TCE PI Trust.[141] Finally, 100% of the affected class voted in favor of the Plan.[142]

C. *Sharpening the Contours of § 105(a) Injunctions*—In re Combustion Engineering

A recent case that addresses the application of § 105(a) to channeling injunctions is the decision in *Combustion Engineering* rendered by the Third Circuit Court of Appeals in December 2004.[143] In *Combustion Engineering*,

133 Confirmation Order, *supra* note 3, at 26–30.
134 *Id.* at 26.
135 *Id.*
136 *Id.*
137 *Id.* at 27.
138 *Id.*
139 *Id.* at 28.
140 *Id.*
141 *Id.*
142 *See* Confirmation Order, *supra* note 3, at 28.
143 *In re* Combustion Eng'g, Inc., 391 F.3d 190 (3d Cir. 2004).

the bankruptcy court approved a plan of reorganization that proposed to channel the asbestos liabilities of the debtor, and two related non-debtor companies, to a settlement trust.[144] Funding for the settlement trust was to be supplied jointly by the debtor and the non-debtor companies in exchange for the issuance of channeling injunctions in their favor pursuant to § 524(g).[145] Certain insurers and asbestos claimants objected to the issuance of the channeling injunction, arguing § 524(g) prohibits including the asbestos-related liabilities of non-debtors within the scope of a bankruptcy court channeling injunction where the liabilities have no relationship to the debtor.[146]

The bankruptcy court recommended confirmation of the plan, including the issuance of a channeling injunction in favor of the non-debtor parties pursuant to § 105(a), as opposed to § 524(g).[147] The bankruptcy court found that three of the *Dow Corning* factors were satisfied, however, two factors were not.[148] The district court affirmed the bankruptcy court's issuance of a § 105(a) channeling injunction in favor of the non-debtors.[149]

On appeal, the circuit court rejected the bankruptcy and district courts' recommendations and held the bankruptcy court lacked "related to" jurisdiction[150] over the independent claims against the non-debtors (those claims unrelated to the non-debtors' relationship with the debtor) and therefore could not enjoin independent claims against the non-debtors in the context of the debtor's plan of reorganization.[151] The circuit court found that the claims against the non-debtors did not threaten to tie up bankruptcy estate assets

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144 *Id.* at 204. The two non-debtor companies, ABB Lummus Global, Inc. and Basic, Inc., were affiliates of the debtor's parent company. *Id.* at 201.

145 *Id.* at 206–07.

146 *Id.* at 208-09.

147 *Id.* at 210. A § 524(g) injunction bars actions against a third party only when such third party is "alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor." 11 U.S.C. § 524(g)(4)(A)(ii) (2000).

148 *In re* Combustion Eng'g, Inc., 295 B.R. 459, 481 (Bankr. D. Del. 2003). Specifically, the court found factors four (the impacted class, or classes, has voted overwhelmingly to accept the plan) and five (the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction) were not clearly established on the record. *Id.* at 484. The court found, however, remedial actions could cure these defects. *Id.*

149 *In re Combustion Eng'g*, 391 F.3d at 213.

150 Bankruptcy courts have jurisdiction over actions both "arising under" and "related to" title 11. 28 U.S.C. § 1334(b) (2000). The test for whether a proceeding is "related to" a case under title 11 is "whether the outcome of the proceeding could conceivably have any effect on the estate being administered in bankruptcy." Pacor, Inc. v. Higgins (*In re* Pacor, Inc.), 743 F.2d 984, 994 (3d Cir. 1984) (emphasis omitted).

151 *In re Combustion Eng'g*, 391 F.3d at 224.

because they arose from separate products, materials, and markets.[152] The circuit court held "[a] corporate affiliation between lateral, peer companies in a holding company structure, without more, cannot provide a sufficient basis for exercising federal subject matter jurisdiction."[153]

The court rejected the equitable argument that the channeling injunction in favor of non-debtors was integral to the plan because it increased the amount of assets available to the settlement trust, stating "[a]lthough the Plan proponents argue that it is efficacious to use § 105(a) to extend injunctive relief in favor of non-debtors in order to create a 'bigger pot' of assets for all of the asbestos claimants, the exercise of bankruptcy power must be grounded in statutory bankruptcy jurisdiction."[154] In the court's view, the simple fact that the structure of the plan depended on the issuance of a channeling injunction to non-debtors did not by itself extend "related to" jurisdiction to claims held independently against the non-debtors.[155]

Further, the circuit court stated, in dicta, the Code precludes the use of § 105(a) as a basis to extend a channeling injunction to non-derivative[156] actions against a non-debtor in the case of asbestos claims because such claims are specifically governed by § 524(g).[157] The non-debtors in *Combustion Engineering* were precluded from obtaining an injunction under § 524(g)(4)(A) for asbestos liabilities that arose independent of the relationship with the debtor.[158] Thus, under *Combustion Engineering*, § 105(a) cannot extend relief in instances where the availability of relief is explicitly circumscribed elsewhere in the Code—namely, into the established boundaries for application of channeling injunctions in asbestos-related litigation under § 524(g).[159]

Combustion Engineering highlights the distinctions between authority to channel liabilities under § 524(g) and authority to obtain injunctions under the general equitable authority of § 105. *Combustion Engineering* clarified the bankruptcy court's power to take whatever action appropriate or necessary in

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[152] *Id.* at 230–31.

[153] *Id.* at 228.

[154] *Id.* at 225.

[155] *Id.*

[156] The claims addressed in *Combustion Engineering* as "non-derivative" were claims for which no nexus was established between the debtor and the liability of the non-debtors. *Id.* at 224.

[157] *Id.* at 236–37. As a procedural matter, the circuit court held the bankruptcy court did not make findings of fact sufficient to support the holding that it had subject matter jurisdiction, and therefore the plan was not confirmable. *Id.* at 219.

[158] *Id.* at 235–38.

[159] *Id.* at 233–34.

aid of the exercise of its jurisdiction should not be confused with the power to take whatever action appropriate or necessary to aid the confirmation of a plan of reorganization.[160]

A critical distinction between *Combustion Engineering* and *Met-Coil* was clarity in the records. In *Met-Coil* the record was clear that (1) any reorganization of the debtor necessarily had to address the alleged liability of Met-Coil's parent and (2) the non-debtor liability subject to the proposed channeling injunction was directly related to the debtor's conduct. If the liabilities of Mestek were not resolved through the bankruptcy, there would be no trust funding, no feasible plan, and less money available for all claimants.[161] The court in *Combustion Engineering* did not have such certainty in the record before it.[162] Indeed, the record indicated "the asbestos-related personal injury claims asserted against Combustion Engineering, Basic and Lummus arise from different products, involved different asbestos-containing materials, and were sold to different markets."[163] The *Combustion Engineering* court held a meaningful and feasible plan of reorganization could be confirmed absent third-party injunctions because no evidence indicated that failure to enjoin claims and future demands against the non-debtor third parties would cause the reorganized entity to fail.[164] The holding in *Combustion Engineering* suggests that although § 105 affords bankruptcy courts ample authority to enjoin claims and demands against non-debtor parties in cases dealing with liabilities other than asbestos liabilities, such authority may only be exercised under circumstances where, because of the relationship between the non-debtor and the debtor, a resolution of the liability of the non-debtor is essential to *any* reorganization of the debtor.[165]

The court in *Combustion Engineering* did *not*, as a general principle, seek to eliminate bankruptcy courts' equitable authority to craft injunctions pursuant to § 105(a).[166] The circuit court focused its opinion on the fact that in *Combustion Engineering*, the non-debtors sought to cleanse themselves of asbestos-related personal injury liability without meeting the requirements of § 524(g).[167] The *Combustion Engineering* plan proponents relied upon cases

160 *Id.* at 226–27.
161 Confirmation Order, *supra* note 3, at 9–11.
162 *See In re Combustion Eng'g*, 391 F.3d at 227–28.
163 *Id.* at 231.
164 *Id.* at 237–38.
165 *Id.* at 238.
166 *Id.*
167 *Id.*

such as *Drexel Burnham Lambert*[168] and *A.H. Robins*[169] to support their argument that § 105(a), irrespective of § 524(g), provided ample authority for the court to enter injunctions in favor of non-debtor parties.[170] The court distinguished *Combustion Engineering* from these cases because Combustion Engineering sought to resolve asbestos liabilities and, as such, the parties were bound to the explicit requirements of § 524(g). The ruling was not based upon a view that courts' latitude in issuing a § 105(a) injunction should be restricted in general, rather, the distinction was § 105(a) is limited in applicability where the action proposed to the bankruptcy court is otherwise subject to an enumerated provision of the Code.[171]

III. WHAT DOES THE FUTURE HOLD FOR FUTURE CLAIMANT TRUSTS?

As *Met-Coil* demonstrates, the use of future claimant trusts in mass-tort-driven bankruptcies is a viable structure for the resolution of environmental mass tort liabilities. Where a company anticipates an ongoing stream of litigation that threatens to cripple—if not destroy—the company's prospects to continue as an ongoing, profitable entity, a mass-tort bankruptcy provides an opportunity to preserve the company as an enterprise in the long term. The transaction costs related to a bankruptcy case are far less likely than the aggregated costs of litigating tort claims individually over time. By bringing finality to its long-term liabilities, a company can gain increased access to capital markets and refocus its management on running a business rather than handling an avalanche of mass tort claims.

The varieties of mass-tort litigation that could potentially trigger a bankruptcy filing are as vast as science (and, cynics may say, the plaintiffs' bar) can reach. In many circumstances in which past or current activities of a company could give rise to vast and persistent tort liability, a company may choose to address both the costs and uncertainty of litigation through a

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168 SEC v. Drexel Burnham Lambert Group, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 960 F.2d 285, 293 (2d Cir. 1992).

169 Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694 (4th Cir. 1989).

170 *In re Combustion Eng'g*, 391 F.2d at 237 n.50.

171 *See id.* at 236–37. The argument as to whether the *Combustion Engineering* court was correct that § 24(g) affects the right of a bankruptcy court to issue a § 105(a) equitable injunction remains open for debate. *See* Bankruptcy Reform Act of 1994, Pub. L. 103-394, § 111(b), 11 U.S.C. § 524 note. Indeed, the debtor in *Combustion Engineering* sought rehearing before the circuit court on precisely this issue. *See* Appellees' Combined Petition for Rehearing and Rehearing En Banc, *In re Combustion Eng'g*, 03-3392 (3d Cir. Dec. 15, 2004). However, the petition for rehearing was denied. *In re Combustion Eng'g*, 391 F.3d at 190.

settlement trust established through bankruptcy. All types of companies, from the world's largest multinational corporations facing a massive docket of tort litigation[172] to smaller, regional companies facing what to them is an overwhelming number of pending and threatened future suits,[173] can benefit from a mass-tort bankruptcy filing.

By way of example, recent studies have begun to assess the extent to which industrial influences on the environment can cause dramatic weather events.[174] Climatologists, in examining the extreme and deadly heat wave that struck Europe during the summer of 2003, have estimated it is very likely that human factors at least doubled the risk of a heat wave of the magnitude observed in that year[175] and, based on their best estimate, humans contributed 75% of the increased risk of such a heat wave.[176] The primary cause cited for this increased risk is the proliferation of greenhouse gases, such as carbon dioxide, in the atmosphere.[177]

Greenhouse gases released from manufacturing plants persist for an average of 100 years in the atmosphere.[178] As such, the release of greenhouse gases today may impact the environment well into the future. The United States accounts for approximately 25% of global greenhouse gas emissions[179] and certain large corporations in specific sectors of the economy are the principal sources of most of these emissions.[180]

In fact, litigation regarding the role of corporations in contributing to unhealthy climate change has already begun. One significant example is the suit filed by eight states[181] and New York City against five North American

[172] *See, e.g., In re* Mid-Valley, Inc., No. 03-35592(JKF), 2004 Bankr. LEXIS 1553 (Bankr. W.D. Pa. July 20, 2004) (Halliburton).

[173] *See, e.g., In re* The Muralo Co., 301 B.R. 690, 699 (Bankr. D.N.J. 2003).

[174] *See* Myles R. Allen & Richard Lord, *The Blame Game: Who Will Pay for the Damaging Consequences of Climate Change?*, NATURE, Dec. 2, 2004, at 551.

[175] Peter A. Stott et al., *Human Contribution to the European Heatwave of 2003*, NATURE, Dec. 2, 2004, at 610.

[176] *Id.* at 612.

[177] *Id.* at 610.

[178] DOUGLAS G. COGAN, CORPORATE GOVERNANCE AND CLIMATE CHANGE: MAKING THE CONNECTION (2003), at 10, *available at* http://www.ceres.org/pub/docs/Ceres_corp_gov_and_climate_change_0703.pdf.

[179] *Id.* at 63.

[180] *See, e.g., id.* at 65–110 (detailing disclosures of certain large corporations in the automobile, electric power, oil and gas, metal, chemical, and other industries).

[181] California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont, and Wisconsin.

power companies.[182] The plaintiffs allege the defendants, the five largest emitters of carbon dioxide in the United States who account for approximately 10% of all man-made carbon dioxide emissions in the country,[183] are contributing to an ongoing public nuisance (global warming), and that their greenhouse gas emissions threaten to shift the global average temperature by a conservative estimate of 2.5 degrees Fahrenheit.[184] This shift would have a number of potential effects, including increased heat deaths, increased suffering from asthma and respiratory diseases, and danger to human life relating to intensified weather events.[185] As of the publication date of this Article, the case remains pending.

As the science of climatology continues to expand and evolve, and science is able to discern with ever greater confidence the impact certain companies' emissions have on public health, the potential for significant litigation will follow close behind. As the litigation history of Met-Coil demonstrates, a definitive causal relationship between claimants' TCE exposure and the claimants' development of cancer cannot, as a matter of scientific certainty, be established. What is compelling to juries and the courts, however, is the science indicating TCE exposure significantly enhances the risks of developing cancer. Likewise, one can imagine, while an individual's death as a result of climatic events could not be definitively linked to the release of greenhouse gases by a manufacturing plant, science could provide enough evidence that, more likely than not, the manufacturer's actions increased the risk of the individual's death.

The impact of this litigation would be colossal. Estimates have placed the number of individuals who died in Europe between August 1 and August 15, 2003 as a result of heat-related illness between 22,000 and 35,000.[186] The number of deaths in fifteen days in Europe is more than the number of asbestos-related personal injury lawsuits pending against Johns-Manville on the day it filed for bankruptcy.[187] If current greenhouse gas emissions do indeed have an effect on global climates over the next 100 years, the number of potential litigants could be staggering.

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[182] Connecticut v. Am. Elec. Power Co., No. 04-Civ-05669-LAP, 2005 Dist. LEXIS 19964, at *1 (S.D.N.Y. Sept. 19, 2005).

[183] Plaintiffs' Complaint, Connecticut v. Amer. Elec. Power Co., at 26, No. 04-Civ-05669 (S.D.N.Y. July 22, 2004).

[184] *Id.* at 25.

[185] *Id.* at 25–26.

[186] Christoph Schär & Gerd Jendritzky, *Hot News from Summer 2003*, NATURE, Dec. 2, 2004, at 559.

[187] See Kane v. Johns-Manville Corp., 843 F.2d 636, 639 (2d Cir. 1988).

But even on a much smaller and more focused scale—communities exposed to toxic chemical releases, product liability mass torts, pharmaceutical exposures—a carefully constructed chapter 11 future claimant trust with a channeling injunction can be an effective and fair procedure to handle a litigation epidemic.

This article is reprinted with permission of the Emory Bankruptcy Developments Journal,
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OUTLINE OF KEY ISSUES FOR ISSUING CHANNELING INJUNCTIONS IN FAVOR OF NONDEBTOR THIRD PARTIES

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I. TWO KEY COMPONENTS TO ANALYSIS -- TO ISSUE PERMANENT INJUNCTIONS IN FAVOR OF NONDEBTOR THIRD PARTIES, COURT MUST HAVE (I) JURISDICTION; AND (II) POWER UNDER THE BANKRUPTCY CODE

A. JURISDICTION (DOES BANKRUPTCY JURISDICTION EXIST)

1. The bankruptcy court must have jurisdiction to entertain an action between the parties.

2. It is universally accepted that a bankruptcy court may have jurisdiction over claims involving nondebtor third parties pursuant to its "related-to" jurisdiction provided under 28 U.S.C. §1334(b).

3. Most courts apply the *Pacor* test in determining whether related-to jurisdiction exists.

    a) The seminal case on related-to jurisdiction is *Pacor Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984), which held that in order for the court to have related-to jurisdiction, the "outcome of [a proceeding involving the third party] could conceivably have any effect on the estate being administered in bankruptcy." The court in *Pacor* further stated that "[a]n action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Id.*

    b) The First, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and Eleventh Circuits have adopted the *Pacor* test with little or no variation. *See, e.g., In re G.S.F. Corp.*, 938 F.2d 1467, 1475 (1st Cir. 1991); *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1002 n. 11 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986); *In re Wood*, 825 F.2d 90, 93 (5th Cir. 1987); *Robinson v. Michigan Consol. Gas Co.*, 918 F.2d 579, 583-84 (6th Cir. 1990); *In re Dogpatch USA Inc.*, 810 F.2d 782, 786 (8th Cir. 1987); *In re Fietz*, 852 F.2d 455, 457 (9th Cir. 1988); *In re Gardner*, 913 F.2d 1515, 1518 (10th Cir. 1990); *In re Munford Inc.*, 97 F.3d 449 (11th Cir. 1996).

c) The Second and Seventh Circuits appear to apply a different test, according to the Supreme Court's interpretation as articulated in *Celotex Corp. v. Edwards*, 514 U.S. 300 (1995). *See In re Turner,* 724 F.2d 338, 341 (2d Cir. 1983) (applies "conceivability" part of *Pacor* without further discussion)*; In re Xonics Inc.,* 813 F.2d 127, 131 (7th Cir. 1987) (holding that a dispute is "related to" the bankruptcy if it affects the amount of property available for distribution or the allocation of property among creditors, but citing, among others, *Pacor*).

d) All courts, however, make clear that bankruptcy courts have no jurisdiction over proceedings that have no effect on the debtor. *See also Celotex Corp. v. Edwards*, 514 U.S. 300 (1995).

4. If the claims or causes of action involve property of the estate, courts applying *Pacor* often conclude that they could have a conceivable effect on the estate such that related-to jurisdiction exists. *In re Wood*, 825 F.2d 90 (5th Cir. 1987); *see also In re Zale Corp.*, 62 F.3d 746, 753 (5th Cir. 1995) (cases in which courts have upheld related-to jurisdiction over third-party actions do so because the subject of the third-party dispute is property of the estate, or because the dispute over the asset would have an effect on the estate). Shared facts between the third-party action and a debtor-creditor conflict do not in and of themselves suffice to make the third-party action related to the bankruptcy. *Id.* Also, judicial economy alone cannot justify a court's jurisdiction over an otherwise unrelated suit. *Id.* at 753-54.

5. If claims or causes of action are not derivative of the debtor's liability and are claims of nondebtors, some courts have been reluctant to find related-to jurisdiction such that they would grant a third party release or injunction. *See In re Combustion Engineering Inc.,* 391 F.3d 190 (3d Cir. 2005).

   - Combustion Engineering sought to obtain a channeling injunction on account of two of its nondebtor affiliates for claims that were not derivative of the debtor's liability.

   - Both the bankruptcy court and the district court held that an injunction pursuant to 11 U.S.C. §105(a) of the Bankruptcy Code barring future claims against these nondebtors on account of non-derivative claims was proper.

   - The Third Circuit Court of Appeals reversed, indicating that (a) the corporate relationship between the three entities was not enough for related-to jurisdiction; (b) tying a sale of one of the nondebtors to contributions under the debtor's plan was not enough, even if all parties consented, because consent does not confer jurisdiction where it is otherwise lacking; (3) cases cited by the debtor were not analogous in so far as they involved derivative claims or claims

that would alter the priority status of the debtor's creditors, which would have effects on the estate; (4) potential indemnification is not enough where no express agreements or statutory requirements for indemnification exist and there is not near certainty of indemnity claims nor liability arising out the same products as the debtor's; and (5) the record was lacking findings regarding the scope, terms, and operation of alleged shared insurance such that the court could not form a basis of related-to jurisdiction on this ground.

- The Third Circuit appeared to indicate that if certain findings were made in terms of shared insurance, depending on the particular facts of a given case, the existence of shared insurance may provide a nexus to the debtor's estate to warrant related-to jurisdiction. However, while the issue was not completely foreclosed, the court was very skeptical as to whether related-to jurisdiction could be found to exist in most contexts involving nondebtors on account of nonderivative claims.

B. POWER (SCOPE AND THE FORMS OF RELIEF THAT THE COURT MAY ORDER IN AN ACTION IN WHICH IT HAS JURISDICTION)

1. Even if the court in a bankruptcy case has jurisdiction over a dispute between third parties, for the court to enter an injunction it must also have the power pursuant to the Bankruptcy Code or any other applicable law, to grant the requested relief and issue an injunction or release in favor of third-party nondebtors.

2. Whether courts have the power to issue injunctions or grant third-party releases effectively discharging the liability of nondebtors centers primarily around conflicting interpretations of §§105(a) and 524(e) of the Bankruptcy Code.

    a) Section 105(a) provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. §105(a).

    b) Section 524(e) provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. §524(e).

3. Section 524(e) arguably restricts the broad equitable authority that §105(a) confers on the courts. However, a number of courts that allow non-debtor releases find no conflict between §§105(a) and 524(e).

4. **The Second, Third, Fourth, Sixth, and Seventh Circuits, and lower courts of the First, Eighth, and Eleventh Circuits are pro-release courts** that hold

that bankruptcy courts have power under §105(a) to issue permanent injunctions or third-party releases under certain factual circumstances. The circumstances vary depending on the jurisdiction:

- First Circuit: Applying *Master Mortgage* factors of the Eighth Circuit. *In re Mahoney Hawkes LLP,* 289 B.R. 285, 302-03 (Bankr. D. Mass. 2002) (noting that the First Circuit Court of Appeals had not directly addressed this issue, but applies *Master Mortgage* factors to conclude injunction inappropriate on the facts); *see also Monarch Life Ins. Co. v. Ropes & Gray,* 65 F.3d 973, 980 (1st Cir. 1995) (lower courts agreeing with pro-release courts that in 'extraordinary circumstances,' a bankruptcy court can grant permanent injunctive relief essential to enable the formulation and confirmation of a reorganization plan, and court of appeals not overturning this result where objector was collaterally estopped by plan confirmation order from belated challenge to the relief and the bankruptcy court's jurisdiction to issue such relief).

- Second Circuit: Courts may issue permanent injunctions for the benefit of third party if the injunction play an "important role in the debtor's reorganization." *In re Drexel Burnham Lambert Group Inc.*, 960 F.2d 285 (2d Cir. 1992); *In re Chateaugay Corp.*, 167 B.R. 776 (S.D.N.Y. 1994) (§524(e) does not address whether a bankruptcy court can expressly discharge or otherwise affect the liability of a nondebtor; thus courts may use §105 to grant third-party releases where they are "essential to the reorganization"); *In re Metromedia Fiber Network Inc.*, 416 F.3d 136 (2d Cir. 2005) (holding that an injunction must play an important part in the debtor's plan, and while no cases from the circuit explain when a release is "important," it is clear that such a release is proper only in rare cases -- a nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan). The *Metromedia* court clarified that two considerations justify the reluctance to approve nondebtor releases: (1) the only explicit authorization in the Bankruptcy Code for this relief is §524(g), applicable only in the asbestos context; and (2) the high possibility of abuse. The *Metromedia* court also makes clear that regardless of the jurisdiction, no court has tolerated third party releases without the presence of unique circumstances.

- Third Circuit. No precise universally adopted test, but courts examine a variety of factors, and require extraordinary circumstances, although some courts note that they are "customary" in large mass tort cases. *See In re American Family Enterprises,* 256 B.R. 377 (D.N.J. 2000) (citing *Drexel* and *Celotex* for such proposition). The *American Family* court also applies a five-factor

test set forth by the Eighth Circuit in *In re Master Mortgage Investment Fund Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994): (1) identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) the nondebtor has contributed substantial assets to the reorganization; (3) the injunction is essential to reorganization; (4) a substantial majority of the creditors agree to such injunction, specifically, the impacted class, or classes, has "overwhelmingly" voted to accept the proposed plan treatment; and (5) the plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.); *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000) (indicating that the Third Circuit had not ruled on the validity of provisions in chapter 11 plans releasing and permanently enjoining third party actions against nondebtors, and that the court would not permit it in this particular case because no findings of fairness or why such relief was necessary were made below or that the nondebtors made any critical financial contributions to the plan).

- Fourth Circuit. Section 524(e) does not by its specific words preclude the discharge of a guaranty when it has been accepted and confirmed "as an integral part of reorganization." *In re A.H. Robins Co. Inc.,* 880 F.2d 694 (4th Cir. 1989) (relying on Fifth Circuit authority). The *Robins* court concludes that §105(a) would be appropriate "where the entire reorganization hinges on the debtor being free from indirect claims such as suits against parties who would have indemnity or contribution claims against the debtor."

- Sixth Circuit. Standard developed in *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002). Court notes that the Bankruptcy Code doesn't explicitly prohibit or authorize a bankruptcy court to enjoin a nonconsenting creditor's claims against a nondebtor to facilitate a reorganization plan. Section 105(a) grants a court broad authority to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Section 1123(b)(6) permits a reorganization plan to "include any . . . appropriate provision not inconsistent with the applicable provisions of this title." Court notes that because a permanent injunction is a dramatic measure to be used cautiously, it follows those circuits that have held that enjoining a nonconsenting creditor's claim is only appropriate in 'unusual circumstances' (agreeing with *Drexel Burnham*, *A.H. Robins Co.*, and *Johns-Manville* courts). It further developed a seven-factor test to determine whether unusual circumstances exist by examining whether: (1) there is an identity of interests between the debtor and

the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) the nondebtor has contributed substantial assets to the reorganization; (3) the injunction is essential to 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.

- Seventh Circuit. Applies no test but indicates that a *per se* rule against permanent injunctions is inappropriate, particularly if such releases are consensual. *In re Specialty Equipment Companies Inc.*, 3 F.3d 1043 (7th Cir. 1993). In *Specialty Equipment,* appellants raised jurisdictional challenge arguing that §524(e) precludes approval of plan releasing nondebtor third parties from liability. The court held that the plan was substantially consummated so the appeal was moot. However, on the merits, the court noted that "a bankruptcy court does have the power to determine the legality of provisions, including releases, incorporated into a reorganization plan. In fact, appellants are not so much challenging the bankruptcy court's subject matter jurisdiction, which is quite broad under §105(a), as they are the legitimacy of the releases included in the plan. Appellants seem to be arguing for a much broader reading of §524(e), one that would effectively preclude a reorganization plan from granting releases to any party other than the debtor. But §524(e) provides only that a discharge does not affect the liability of third parties. This language does not purport to limit or restrain the power of the bankruptcy court to otherwise grant a release to a third party. While a third-party release may be unwarranted in some circumstances, a *per se* rule disfavoring all releases in a plan would be similarly unwarranted, if not a misreading of the statute. Accordingly, courts have found releases that are consensual and noncoercive to be in accord with the strictures of the Bankruptcy Code." (*citing AOV Industries*, 792 F.2d at 1145; *In re Monroe Well Serv. Inc.*, 80 B.R. 324 (Bankr. E.D. Pa. 1987). Unlike the injunction created by the discharge of a debt, a consensual release does not inevitably bind individual creditors. It binds only those creditors voting in favor of the plan of reorganization.

- Eighth Circuit. Applies five-factor test. *In re Master Mortgage Investment Fund, Inc.* 168 B.R. 930 (Bankr. W.D. Mo. 1994).

Court noted that §524(e), on its face, does not restrict a bankruptcy court's power to issue a permanent injunction. Then the court notes that five factors are typically considered: (1) identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) the nondebtor has contributed substantial assets to the reorganization; (3) the injunction is essential to reorganization; (4) a substantial majority of the creditors agree to such injunction, specifically, the impacted class, or classes, has "overwhelmingly" voted to accept the proposed plan treatment; and (5) the plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction. Court also notes that "these factors do not appear to be an exclusive list of considerations, nor are they a list of conjunctive requirements." *See also In re Chiles Power Supply Co.,* 264 B.R. 533 (Bankr. W.D. Mo. 2001) (issues permanent channeling injunction on third-party products claims pursuant to §105).

- Eleventh Circuit. For a debtor to confirm a plan containing a nondebtor release, the debtor must demonstrate that *unusual circumstances* exist, and that the nondebtor release is *fair and necessary*, utilizing those *Dow Corning* factors that are applicable. A case-by-case analysis is required. Allowing the nondebtor release is the exception, not the norm. *In re Transit Group Inc.*, 286 B.R. 811 (Bankr. M.D. Fla. 2002). *See also In re Munford Inc.,* 97 F.3d 449 (11th Cir. 1996) (approving third-party nondebtor releases in a settlement agreement in a related adversary proceeding).

5. **The D.C. Circuit does not address directly this issue of whether a bankruptcy court has the authority to permit third-party nondebtor releases or permanent injunctions in a reorganization plan under chapter 11. However, this court specifically aligns itself with the pro-release courts.** *In re AOV Indus. Inc.*, 792 F.2d 1140 (C.A.D.C. 1986) (affirming confirmation of a plan of reorganization, noting that the district court held that the plan's releases did not constitute an impermissible discharge of nonpetitioning third parties, contrary to §524(e), rendering appellants' challenge to confirmation of the plan moot).

6. **The Fifth Circuit has approved of the issuance of third-party injunctions, but only in the case of *temporary* injunctions.**

   - Rationale: jurisdiction should extend only to temporary injunctions, not permanent injunctions because permanent injunctions are outside the jurisdiction -- claims will have no effect on the estate after confirmation of the plan. Confirmation of a plan and close of a case will mean that the nexus between the related claim and bankruptcy