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Representatives Committee On The Judiciary

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Mr. Chairman and members of the Subcommittee, I am Lester Brickman, a Professor of Law at the Benjamin N. Cardozo School of Law of Yeshiva University. I want to thank the Committee for inviting me to speak at this oversight hearing on the “Administration of Large Bankruptcy Reorganizations: Has Competition for Big Cases Corrupted the Bankruptcy System?” I will focus my remarks on the process of administering the major bankruptcies of former producers and sellers of asbestos-containing products. My testimony will consist of the following:

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I. Qualifications

I have had a long-standing research interest in asbestos litigation. In 1991, on the basis of knowledge and expertise that I had acquired on the subject, I was requested by the Administrative Conference of the United States, an executive branch agency of the federal government, to draft a proposed administrative alternative to asbestos litigation and to organize a colloquy to consider and debate that proposal. As stated by the Chairman of the Administrative Conference:

[W]e asked Professor Lester Brickman to prepare a paper proposing an administrative claims solution for comment and criticism by the panel, and we look forward to comments by the audience. Let me introduce Professor Brickman, who teaches law at Cardozo Law School, Yeshiva University. He is a leading authority in the area of attorney's fees and has written numerous articles on the subject. Professor Brickman became interested in the subject of asbestos litigation some years ago when he was hired as a consultant by one of the defendants in the asbestos litigation to review contingent fee issues. He has since had the opportunity to extensively review empirical data, case files, and other materials on the subject. Because of his work in this area, we asked Professor Brickman to draft a proposed administrative solution which our panelists have been invited to criticize.¹

Over the past fourteen years, I have devoted a substantial amount of time to research on asbestos litigation and have published four articles on the subject.² In these articles, I discuss the nature of asbestos-related disease; the history of asbestos litigation, including the phenomenon of the unimpaired claimant; the role of attorney-sponsored screenings; the effective hourly rates generated by contingent fee-financing of the

¹ Administrative Conference of the United States, Colloquy: *An Administrative Alternative To Tort Litigation To Resolve Asbestos Claims*, October 31, 1991, Transcript at 4.

² *The Asbestos Litigation Crisis: Is There A Need For An Administrative Alternative?*, 13 Cardozo L. Rev. 1819 (1992); *The Asbestos Claims Management Act of 1991: A Proposal To The United States Congress*, 13 Cardozo L. Rev. 1891 (1992); *Lawyers' Ethics And Fiduciary Obligation In The Brave New World Of Aggregative Litigation*, 26 Wm. & Mary Envtl. L. & Pol'y Rev. 243, 272-98 (2001); *On The Theory Class's Theories of Asbestos Litigation: The Disconnect Between Scholarship and Reality*, 31 Pepp. L. Rev. 33 (2004).

litigation and the effect of those fees on the litigation; the use and effects of forum selection; the impact of mass consolidations; and the culmination of the litigation in the bankruptcy of many former producers and sellers of asbestos-containing products and the administration of that bankruptcy process.

Finally, my qualifications as an expert on asbestos litigation, attorney-sponsored screenings, the formation and structure of asbestos bankruptcy trusts and the “trust distribution procedures” adopted by extant trusts as well as those proposed in pending bankruptcies, were confirmed after being challenged in a recent asbestos bankruptcy proceeding.³

II. Asbestos Litigation: An Update

Asbestos litigation remains a high growth enterprise. In 2003, more than 110,000 new claimants surfaced – the most ever in a single year. Since each claimant files claims against approximately 30-60 different defendants and bankruptcy trusts, this translates into approximately 5,000,000 new claims which will have been generated by just these claimants. While approximately 750,000 claimants have so far filed claims against over 8500 different defendants, it is estimated that 1,600,000 to 2,100,000 new claimants will yet emerge.⁴ Moreover, while defendants and their insurers have so far paid out over 70 billion dollars, it is estimated that former asbestos-containing product manufacturers, owners of premises containing asbestos and their insurers will have to pay out an additional \$130-\$140 billion before the litigation is concluded.

³ In re Western Asbestos Co. et al., Debtors, 2003 Bankr. LEXIS 1894 at *3 (Oct. 31, 2003).

⁴ Letter from David Austern, President, Claims Resolution Management Corporation, Manville Personal Injury Settlement Trust to Hon. Patrick J. Leahy, United States Senate Committee on the Judiciary 2 (July 8, 2003) (on file with the author).

So far the litigation has accounted for approximately 70 bankruptcies including, in recent years, such companies as Owens Corning, W.R. Grace, Armstrong World Industries, Babcock & Wilcox, Federal Mogul and Combustion Engineering. I note that negotiations are currently underway in the Senate to remove the litigation from the judicial system and provide an alternative administrative resolution. No end is yet in sight, however, as what has become a weapon of mass business destruction cuts deeper and deeper into the American industrial process and product distribution system. If the litigation continues along its current path, many more bankruptcies will ensue – scores if not hundreds of companies, big and small, will almost certainly succumb as will a number of insurance companies.

III. The Need For Congressional Oversight Hearings

This hearing is taking place at a time when there is mounting evidence that the processes of negotiating and administering asbestos bankruptcies have become deeply flawed and in need of both a full scale investigation and legislative changes. I need only refer to a few of the most recent events such as the accounts in the press and elsewhere of the troubling conduct of several Advisors retained by Judge Alfred Wolin which led the Third Circuit Court of Appeals to issue a writ of mandamus removing Judge Wolin from presiding over several of the major asbestos bankruptcies now underway. In addition, there is the resignation, under fire, of Professor Francis E. McGovern from the roles of mediator and advisor in a number of these bankruptcies, accompanied by his candid admission that the system is not only “broken” but that it “is going to get worse” as well as his chilling statement, presumably in reference to the proceedings he was witnessing

and participating in, including those before Judge Wolin, that “[t]here are bad things going on here.”⁵

To properly assess how the bankruptcies of these and other former producers and sellers of asbestos-containing materials are being negotiated by the parties and administered by the courts, it is first necessary to have an understanding of the underlying litigation that has generated such an unprecedented number of bankruptcies and threatens scores if not hundreds of additional businesses.

IV. An Overview of Asbestos Litigation

The modern era of asbestos litigation began in 1973 when the United States Court of Appeals for the Fifth Circuit, responding to revelations of a conspiracy to suppress information regarding the hazards of asbestos inhalation,⁶ allowed workers injured by exposure to asbestos to hold manufacturers of those products and others strictly liable for failure to warn that their products were unreasonably dangerous.⁷ That holding enlarged what had been workers’ compensation claims against employers into products liability claims against manufacturers and others.

Much of the ensuing litigation targeted the Johns-Manville Corporation, the principal miner of asbestos and the leading manufacturer of asbestos-containing material. In 1982, the company declared bankruptcy. After a protracted bankruptcy proceeding, the Manville Personal Injury Trust (“Manville Trust”) was established in 1988 -- the first

⁵ Editorial (*St. Francis of Asbestos*), Wall St. J. June 15, 2004 at A14.

⁶ See PAUL BRODEUR, *OUTRAGEOUS MISCONDUCT* (1985).

⁷ *Borel v. Fibreboard Prod. Corp.*, 443 F.2d 1076 (5th Cir. 1973), *cert. denied*, 419 U.S. 869 (1974).

in a succession of approximately fifteen such trusts set up after bankruptcies of approximately 70 companies thus far in the course of asbestos litigation.

To that point, most asbestos litigation involved seriously injured claimants: those stricken with mesothelioma, a deadly cancer, and serious cases of asbestosis which could also be deadly and at least were debilitating, where exposure and causation could readily be established. However, at the time of the creation of the Manville Trust, trends were already developing of plaintiffs seeking compensation based on increasingly deficient evidence of causation and injury. For example, plaintiffs advanced claims which included statements by doctors that claimants' lung conditions were "consistent with asbestosis," even though that is not a diagnosis and even though many causes other than exposure to asbestos can account for the same conditions. Plaintiff lawyers increasingly sought aggregations of claims that were of sufficient magnitude to force defendants to settle cases that they often would have won had they been individually tried, including cases that plaintiff lawyers never even would have brought but for the aggregation.

A dominant feature of asbestos claiming from the mid-1980s to the early-mid 1990s was the prevalence of pleural plaque claims. The vast majority of those with pleural plaques have no symptoms, no diminished lung capacity, no greater likelihood of developing a malignancy than similarly exposed workers who do not have pleural plaques, and also a considerably diminished likelihood of thereafter developing asbestosis than others similarly exposed who have not been found to have pleural plaques.⁸ In many jurisdictions, there is no legal basis for valuing such claims since no injury has occurred. Nevertheless, tens of thousands of these claims were filed,

⁸ See Lester Brickman, *On The Theory Class's Theories of Asbestos Litigation: The Disconnect Between Scholarship and Reality*, 31 Pepp. L. Rev. 33, 51-54, 60 (2004) (hereinafter Brickman, *Theories of Asbestos Litigation*). The article may be accessed at www.ssrn.com/abstract=490682.

consuming hundreds of millions of dollars that would otherwise have been available to injured claimants.

A dominant feature of asbestos claiming today which has its origin in the early-mid 1990s is the enormous increase in the claims of 1/0 asbestosis by unimpaired persons.⁹ This is occurring in the teeth of reports of leading medical researchers who have called asbestosis a “disappearing disease,”¹⁰ and a condition that is “exceedingly rare.”¹¹ Other medical researchers have stated that “we have not seen a single case of significant asbestosis with first exposure during the past 30 years.”¹²

Approximately 10% of asbestos claims involve malignancies. The substantial majority of the remaining 90% allege mild asbestosis and to a lesser extent, pleural plaques.¹³ Most of these claimants have no lung impairment but are characterized as having an asbestos-related injury or illness on the basis of x-ray readings by certified specialists known as B-readers. Of the 91,000 new claims presented to the Manville Trust in 2001, approximately 90% were 1/0 asbestosis claims gathered by attorney sponsored asbestos screenings. Medical reports of “consistent with asbestosis” or diagnoses of 1/0 asbestosis were presented even though there are more than 150 causes of fibrosis other than asbestos exposure.¹⁴ Among the other causes of lung conditions which

⁹ For an explanation of asbestosis and of the significance of a 1/0 x-ray reading on the ILO scale, see *Theories of Asbestos Litigation*, *id.* at 46-51, 61-62.

¹⁰ K. Browne, *Asbestos-Related Disorders*, *Occupational Lung Disorders*, 3rd, 410 (1994).

¹¹ Letter from Dr. James Crapo, Report Of The Senate Judiciary Committee on S.1125, “The Fairness In Asbestos Injury Resolution Act of 2003,” July 30, 2003 at 18.

¹² Jederlinic & Churg, *Ideopathic Pulmonary Fibrosis In Asbestos-Exposed Workers*, 144 *Am. Rev. Resp. Dis.* 695-96 (1991).

¹³ See *Theories Asbestos Litigation*, *id.* at 44-55, 60-62.

can be read as 1/0 asbestosis are smoking, obesity, old age, lupus, silicosis and numerous other medical conditions. Virtually all adults in the U.S. have millions of asbestos fibers in their lungs, yet suffer no adverse affects on their health. Indeed, “a sizeable portion of the adult population has lung conditions that could be diagnosed as [1/0] asbestosis.”¹⁵ One study indicates that 35.5% of a population not known to have industrial exposure to asbestos were nonetheless found to have lung conditions that could be diagnosed as asbestosis according to the standards used by the B-readers hired by plaintiff lawyers.¹⁶

It has now been almost 30 years since large numbers of workers were exposed to high levels of friable asbestos fibers in the course of their employment. Based upon the latency periods associated with asbestos related diseases, rates of disease manifestation should have begun to significantly decline by no later than the mid-1990s. But contrary to the predictions of medical science and despite the medical studies indicating that the vast majority of claimants are misdiagnosed and do not have an asbestos-related injury recognized by medical science,¹⁷ asbestos litigation continues to expand at a substantial rate. The reason for this has become clear. Most current claims of injury made in the course of asbestos litigation have little to do with actual injury but rather are a function of the compensation system. If compensation is available, claims will be forthcoming. As a leading medical expert in asbestos-related diseases has stated:

[c]laimants are being compensated for illnesses that, according to the clear weight of medical evidence, either are not caused by asbestos or do not

¹⁴ Hearings on Asbestos Litigation before the Committee on the Judiciary, U.S. Senate, Prepared Statement of Steven Kazan, Sept. 25, 2002, at 22 n.63 (hereinafter Kazan Statement).

¹⁵ Kazan Statement, *id.* at 25.

¹⁶ *See* Theories of Asbestos Litigation, *id.* at 107.

¹⁷ *Id.* at 103-108.

result in a significant impairment -- i.e., are not generally regarded by the medical profession as an illness. Projection of these claims is inherently uncertain. Simply put, when medical research concludes that a condition is not caused by asbestos, or is not an illness at all, medical research will not be able to predict the number of such claims.¹⁸

Beginning in the mid-1980s and continuing to this day, asbestos litigation has become increasingly driven by the entrepreneurial activity of plaintiff lawyers who sponsor mass recruitment efforts by enterprises created by individuals with no background in health administration, specifically and solely to generate claims.

It is important to note the great divide between asbestos screenings and medical screenings. The latter seek to detect early signs of disease for the purpose of instituting a regime of treatment. Asbestos screenings, conversely, are not intended to and do not provide any material health benefits; rather they are intended primarily to identify and recruit "litigants." This has generated tens of millions of dollars in fees and payments to screening enterprises and the doctors they employ and billions of dollars in fees for lawyers. As one asbestos plaintiff lawyer has acknowledged, attorney sponsored mass screenings are different from the model of

traditional toxic tort litigation [,which] follows a medical model: a plaintiff sees a doctor to treat his illness of injury and then is referred to, or otherwise finds, a lawyer. [Asbestos] screening substitutes an *entrepreneurial model*: the lawyer recruits the plaintiff -- who usually feels fine, has no symptoms or impairment, and is unaware of any "injury" -- and sends him to a screening company for an x-ray.¹⁹

Substantially all nonmalignant claims being brought today are generated by those screenings. So far these entrepreneurial enterprises have organized screenings of

¹⁸ Letter from Dr. James Crapo to Senator Jon Kyl, June 23, 2003, quoted in Senate Judiciary Committee Asbestos Report, *id.* at 79.

¹⁹ Kazan Statement, *id.* at 19-20 (emphasis added).

upwards of one million industrial plant and construction workers who could claim exposure to asbestos containing products at their job sites before 1972.²⁰ The enterprises contact union locals who cooperate in setting up screenings because they can provide union members with “a little cash to add to their retirement funds,” or “to buy the fishing boat.” As one screened worker noted, “It’s better than the lottery. If they find something, I get a few thousand dollars I didn’t have. If they don’t find anything, I’ve just lost an afternoon.”²¹ With such promotional come-ons as “Find out if YOU have MILLION DOLLAR LUNGS,” millions of mailings announcing the screenings have been sent out to employees and former employees promising “free x-rays” and the opportunity to cash in even though they were not sick and exhibited no symptoms. Mobile x-ray vans are brought to union halls, motels, strip malls, etc. to take x-rays at an assembly line rate of one every five minutes. A select few handfuls of B-readers and doctors cooperate with the enterprises by “diagnosing” massive numbers of those screened as having asbestosis or conditions “consistent with asbestosis.” For those so diagnosed, pulmonary function tests, ostensibly to measure lung impairment, are then administered.

As part of the screening process, plaintiff lawyers retain B-readers with heightened propensities to “diagnose” x-rays taken at the screenings as indicating a grade of 1/0 asbestosis, using the International Labour Organization (“ILO”) grading system. Doctors interviewed by the American Bar Association Commission on Asbestos Litigation reported having “seen hundreds or even thousands of examples of over-reading

²⁰ The operations of screening enterprises are examined in detail in *Theories of Asbestos Litigation*, *id.* at 62-103.

²¹ Andrew Schneider, *Asbestos Lawsuits Anger Critics*, St. Louis Post-Dispatch, Feb. 11, 2003.

of x-rays for litigation purposes.”²² One doctor reviewed the medical records of 15,000 people who had been diagnosed with asbestosis based solely on x-ray readings, and determined that “only 10% of the persons could validly be diagnosed with asbestosis.”²³ “Another doctor reported a 62% error rate on review of x-ray screening results previously read as ‘consistent with asbestosis,’”²⁴ and a third doctor reviewed 22,000 asbestos-related claims and “found a presumptive x-ray review error rate of up to 86% among 5 readers, none of whose results matched the general patterns in epidemiological studies.”²⁵

While x-rays can reveal fibrosis, x-rays cannot measure the existence, degree or severity of pulmonary dysfunction or whether the condition is obstructive or restrictive. In addition, a complete medical examination and work history would be required in a medical setting to determine whether a fibrosis has been caused by exposure to asbestos as opposed to exposure to other dusts, such as silica or cotton dust.

Pulmonary function is measured by performance on a variety of breathing tests called pulmonary function tests (“PFTs”). These tests, when properly administered, provide objective, quantifiable measures of lung function to determine whether an individual is impaired and, if so, to what degree. They are the primary means of evaluating non-malignant asbestos-related personal injury claims and are widely used by both plaintiffs and defendants to determine the settlement values of claims and as evidence in trials.

²² Report of the American Bar Ass’n Com’n on Asbestos Litigation, Feb. 2003, at 10.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

There is considerable evidence that PFTs administered by attorney sponsored asbestos screenings systematically and deliberately deviate from standards established by the American Thoracic Society (“ATS”) in order to generate PFT results which falsely indicate pulmonary impairment.

According to testimony of screening company representatives and the B-readers and other doctors hired by plaintiff lawyers, 20-35% of those processed by attorney sponsored asbestos screenings are found to have 1/0 asbestosis. This percentage is itself evidence of systematic misdiagnosis of asbestosis. As noted, neutral medical doctors and scientists declared asbestosis a disappearing disease a decade ago. Moreover, studies done a decade ago indicate that the percentage of actual asbestosis to be found in mass screenings of industrial worker is in the range of 2.5%.²⁶

On the basis of research that I have undertaken, I have concluded that the actual percentage of those screened at attorney sponsored asbestos screenings who are found positive on the basis of x-rays is in the 60-80% range and, of those, 60%-80% are found impaired on the basis of pulmonary function tests administered at the screenings.²⁷ This is near conclusive evidence of manifest misdiagnosis on a mass scale.

The most reasonable explanation why diagnoses of asbestosis generated by attorney sponsored asbestos screenings exceed actual rates of asbestosis by margins of 50:1-100:1 is the financial incentives that permeate the screening process. These incentives include:²⁸

²⁶ See Theories of Asbestos Litigation, *id.* at 104-05.

²⁷ *Id.* at 83-90.

²⁸ *Id.* at 90-97.

a) The screening enterprises which generate the x-rays for B-readers and which administer pulmonary function tests operate at a furious pace since volume equals income. The resultant poor quality of x-rays renders misdiagnosis more likely since 1/0 asbestosis is itself often a highly subjective judgment. In addition, PFTs administered at screenings fail to comply with ATS standards, and frequently are misadministered both to increase the volumes of such tests in a given time period and to generate false outcomes of “impairment.”

b) Some screening enterprises are paid substantially higher fees for each positive-for-asbestosis outcome they produce for the lawyers who hire them than for each negative outcome.

c) Although many B-readers charge relatively low fees per x-ray, the income that they generate in the aggregate from such readings is substantial -- in the millions of dollars for the selected few – because of the high volumes. This financial incentive has profound effects. Though there are approximately 500 B-readers in the United States, only a few handfuls have been selected to read x-rays by plaintiff lawyers. According to the Manville Trust, 49.6% of the tens of thousands of non-malignancy claims it receives that identify a doctor are based on the B-reads of just 10 doctors. These B-readers reliably find 1/0 asbestosis even though neutral readers conclude that the error rates are huge: well over 50%. B-readers who reliably read x-rays as indicating 1/0 asbestosis are rewarded with increased business. Indeed, there is specific empirical evidence that the B-readers most often selected by plaintiff lawyers conform their readings to the specific demands of the law firms that retain them. And if, in the unlikely case that “the doctor does not give the lawyer the right answer [i.e., 1/0 asbestosis], the lawyer can get a

second opinion, or a third, or a fourth. . . as many as it takes.”²⁹ Indeed, one doctor who regularly testifies as an expert for plaintiffs stated that “in some of the screenings, the worker’s x-ray had been ‘shopped around’ to as many six radiologists until a slightly positive reading was reported by the last [doctor].”³⁰

That many of the medical reports and diagnoses produced by attorney sponsored asbestos screenings lack accuracy is further buttressed by analysis of the massive shift from findings of pleural plaques to findings of asbestosis. From the late 1980s to the early 1990s, pleural plaque claims accounted for approximately 45-60% of asbestos claim volumes. Beginning by the mid-1990s, a massive shift in the mix of claimed diseases occurred. B-readers essentially ceased finding pleural plaques in x-rays and instead found 1/0 asbestosis or conditions “consistent with asbestosis.” Thus they were diagnosing new claimants as having asbestosis or conditions “consistent with asbestosis,” not pleural plaques, even though these claimants had worked alongside other claimants at identical work sites at the same times who were previously determined by B-readers to have pleural plaques, rather than asbestosis.³¹

The explanation for this tectonic shift in medical reporting is that, as earlier indicated, asbestos claiming today is largely a function of the compensation system, not of medical science. More specifically, the global *Georgine* settlement,³² later invalidated by both the Third Circuit Court of Appeals and the U.S. Supreme Court,³³ included

²⁹ Kazan Statement, *id.* at 21-22.

³⁰ David Egilman, Asbestos Screenings (letter), 42 *Am. J. Indus. Medicine* 163 (May 2002).

³¹ *See Theories of Asbestos Litigation, id.* at 108-10.

³² *Georgine v. Amchem Products, Inc.*, 878 F. Supp. 716 (E.D. Pa. 1994).

³³ *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), *aff'g* 83 F. 3d 610 (3d Cir. 1996).

provisions that would have effectively valued future pleural plaque claims at zero. In reaction to the settlement, other plaintiff lawyers immediately began reclassifying what would have been new pleural plaque claims as asbestosis claims -- a phenomenon that compellingly suggests that prior claimants, so diagnosed, did not have pleural plaques, and that current claimants being diagnosed with 1/0 asbestosis or conditions “consistent with asbestosis” do not have asbestosis.

Faced with the unprecedented deluge of claims generated by attorney sponsored asbestos screenings supported by B-readers’ unsupportable declarations of asbestosis or “consistent with asbestosis” and systematically misadministered PFTs, as well as the enormous defense costs that were being incurred to defend against these claims in numerous jurisdictions, often simultaneously, several defendants attempted to control the rate of claiming and the expenses they were incurring by entering into agreements with plaintiff lawyers to settle their current inventory of cases and new claims, as they would arise, according to an agreed upon matrix of claim values. These attempts to tame litigation costs failed, as attorneys took advantage of lax--and even nonexistent--claiming requirements to assert hundreds of thousands of claims that lacked actual medical diagnoses and competent evidence of exposure.

V. Asbestos Litigation: A Summary of My Research Findings

On the basis of my research, I have concluded that asbestos litigation today mostly consists of:

(1) a massive client recruitment effort accounting for 90 percent of all claims currently being generated and resulting in the screening of well over 1,000,000 “litigants” in the past 15 years;

(2) generating claims of injury though most of these “litigants” have no medically cognizable asbestos–related injury and cannot demonstrate any statistically significant increased likelihood of contracting an asbestos-related disease in the future;

(3) which claims are often supported by specious medical evidence, including: (a) evidence generated by the entrepreneurial screening enterprises and B-readers – specially certified x-ray readers that the plaintiff lawyers select because they produce “diagnoses” which are not a product of good faith medical judgment but rather a function of the millions of dollars a year in income they receive for these services, and (b) pulmonary functions tests which are often administered in knowing violation of standards established by the ATS and consequently result in findings of impairment which would not otherwise be found but for the improper administration of these tests;

(4) and which claims are further supported by “litigants” testimony which frequently follows scripts prepared by their lawyers which are replete with misstatements with regard to: (a) identification and relative quantities of asbestos-containing products that they came in contact with at work sites, (b) the information printed on the containers in which the products were sold, and (c) their own physical impairments;³⁴

(5) being asserted in a civil justice system that has been altered to accommodate the interests of these “litigants” and their lawyers by dispensing with many evidentiary requirements and proof of proximate cause, giving rise to what I have termed “special asbestos law.”³⁵

³⁴ These conclusions are documented in *Theories of Asbestos Litigation*, *id.*

³⁵ *Id.* at 54-59.

It is thus beyond cavil that asbestos litigation represents a massive civil justice system failure. Indeed, in my study, I conclude that the litigation has become a “malignant enterprise.”

VI. Bankruptcy: The Inexorable End Game of Asbestos Litigation

A. Introduction

An increasing amount of asbestos claiming is now being channeled through the bankruptcy process where such proceedings are largely insulated from public view. The issues are complex and newspaper coverage fails to inform the public of what is occurring which, in plainest terms, amounts to a perversion of legal process. The leading plaintiff law firms, a baker’s dozen or so, exercise substantial if not near total control over the bankruptcy process. While Congress has granted the U.S. Trustee authority to select the members of the various committees, which includes the members of the “asbestos creditors committee” (“ACC”),³⁶ in reality, it is the leading plaintiff law firms that select themselves onto the ACC. To be sure, the U.S. Trustee does select tort creditors to be on the ACC but the practice is for those members to cede control to their attorneys through powers of attorney. The appointed members of the ACC immediately fade from view. Laden with boundless conflicts of interest which are largely ignored by bankruptcy judges and the U.S. Trustee, this handful of law firms not only constitute the asbestos creditors’ committee, they create the bankruptcy plans, establish the criteria for the payment of the very claims which they are asserting, effectively select the trustees to operate the §524(g) bankruptcy trusts that will be created to actually pay the claims (with

³⁶ 11 U.S.C. §1102.

the approval of the bankruptcy court which virtually always is forthcoming) and constitute the Trust Advisory Committees which have authority over trustees' actions and veto power over changes in the trusts' structure. The Trust Distribution Procedures ("TDPs") they create allow these lawyers to treat substantial portions of the trusts' funds as "piggy banks," essentially accessible at will irrespective of whether a claimant is actually injured or had actual exposure to defendants' products, let alone whether the exposure was a substantial factor causing injury. In fact, in some bankruptcy TDPs, all that is required to "prove" the requisite exposure is for the claimant to sign a form saying he was exposed.

The bankruptcy trusts are being created as a result of the enactment by Congress in 1994 of §524(g), a special set of bankruptcy provisions designed to facilitate the reorganization of firms with asbestos liabilities.³⁷ Under these provisions, the asbestos claims against an insolvent debtor are channeled to a "trust" which is funded by equity provided by the debtor and increasingly, by the debtor's insurance coverage. As I will explain in this statement, in practice, this provision richly rewards lawyers for recruiting claimants, especially those who have no injury, let alone a lung impairment resulting from exposure to asbestos, and is further being applied in a perverse manner which subverts its purpose as well as the larger purposes of the Bankruptcy Code.

Though bankruptcy trust assets already approximate \$6 billion, that amount pales when compared to an additional anticipated \$40 billion to be added to trust assets³⁸ as up

³⁷ 11 U.S.C. §§524 (g)-(h).

³⁸ The actual amount to be added to these trusts may be less than \$40 billion because several insurance companies which will be contributing funds to the trusts are likely to be bankrupted by their asbestos liabilities. Moreover, one or more reinsurance companies may decide to abandon the American market rather than continue to pay out huge sums for asbestos liability. Few insurance companies, if any, have established reserves sufficient to fund their anticipated asbestos liabilities.

to a score of companies now in bankruptcy, including Owens Corning, W.R. Grace, Armstrong World Industries, USG, Combustion Engineering, Congoleum, Burns & Roe, Pittsburgh Corning, Federal Mogul, G-I Holdings (the former GAF), Babcock & Wilcox, and DII Industries and Kellogg Brown and Root,³⁹ subsidiaries of Halliburton, establish such trusts. When that occurs, “piggy banks” with approximately \$45 billion in assets will be in place which plaintiff lawyers will be able to tap essentially at will.

B. Asbestos Bankruptcy Trusts

Approximately fourteen bankruptcy trusts have been established thus far in the course of the more than 70 bankruptcies of companies faced with substantial asbestos liabilities. Most of these bankruptcies have resulted from the overwhelming number of claims as described above and the settlement postures forced onto defendants. As a plaintiff lawyer specializing in asbestos claims has observed, prior to bankruptcy defendants are often “force[d] to . . . settle. . . cases whether or not they have merit under state law.”⁴⁰ Unfortunately, the advent of bankruptcy does not resolve the problem of overwhelming numbers of meritless claims. Instead, an analogous set of problems surface when these claims are presented to the trusts created in the aftermath of bankruptcies.

Because the bankruptcy trust creation process historically has been largely dictated by plaintiff lawyers, the trusts have not been structured to effectively distinguish between valid claims by plaintiffs who are actually sick as a result of exposure to

³⁹ This restructuring plan was approved on July 16, 2004 and provides for payment of \$4.2 billion into the bankruptcy trust.

⁴⁰ Kazan Statement, *id.* at 20.

debtors' products and the hundreds of thousands of invalid claims brought by unimpaired asymptomatic claimants or claimants lacking significant exposure to debtors' products. Instead, these trusts have been structured to favor the interests of the lawyers controlling the creation of the trust by paying their claims earlier and at higher levels than claims which arise later in the process, without regard for merit or causation. This has resulted in the rapid depletion of trust assets.

The first and largest of the bankruptcy trusts, the Manville Trust ("MT"), was established in 1988 with the transfer of almost \$2 billion in Johns-Manville assets after the latter's bankruptcy filing in 1982.

The MT was structured by the lawyers who had the greatest number of claims against the company. These lawyers were appointed to what was officially called the Asbestos Health Claimants Committee, a committee consisting of 26 plaintiff attorneys and one claimant. As noted in a very detailed and insightful examination of the Manville Trust's origin, "[b]ecause [these] committee members would take home a portion of any settlements, they had more than the usual vested interest in the bankruptcy's outcome."⁴¹

The stated purpose of the MT was to establish an administrative process that would deliver fair, adequate and equitable compensation to present and future asbestos claimants without the need for litigation. This goal was to be effectuated by the Manville Trust Distribution Procedures ("MTDP"), which provided that claimants would be paid a fixed sum in accordance with the classification of the condition upon submission of minimal proof of exposure to a Manville product and the existence of an asbestos related medical condition. Thus, the MT was structured in favor of ease of filing at the expense

⁴¹ Amy Singer, *Leon Silverman, His Clients, The American Lawyer*, Oct. 1990, at 58, 60.

of accuracy in claiming. This accorded with the interests of the plaintiff lawyers who structured the MT. They had devised a plan which “was doomed to fail,”⁴² but which would reward them with enormous fees. Moreover to facilitate this plan, these plaintiff lawyers selected the then executive director of the Association of Trial Lawyers of America to head the MT.

The immediate consequence of a structure devised by plaintiff lawyers and run by a representative of the plaintiff lawyers was a feeding frenzy. Funds were paid out so precipitously that the MT, after distributing \$677,445,619, quickly became insolvent and itself required restructuring. The fund payout generated huge rewards for the lawyers who were first in line, most especially those who controlled the process of creating the trust. Of the aggregate payout, plaintiff lawyers received approximately \$266 million. I have estimated that the effective rate realized by those plaintiff lawyers was \$5,000 per hour, even though those claims were, for the most part, not disputed in the trust process, were settled in batches of hundreds or thousands and involved little risk for the lawyer.⁴³ Even under the reorganized MT, where attorney fees were capped at 25%, I have estimated that plaintiff lawyers averaged \$1,500-\$2,750 per hour for filing what were essentially administrative claims.

The effect of the failure of the MT to have created a structure and trust distribution procedures to distinguish between valid claims and those that lacked merit was further amplified by the *Georgine* settlement.⁴⁴ As indicated, that settlement led

⁴² *Id.* at 58

⁴³ See Lester Brickman, *The Asbestos Litigation Crisis: Is There A Need For Administrative Alternative?*, 13 *Cardozo L. Rev.* 1819, 1835 n.61. No plaintiff lawyer, to my knowledge, has taken issue with my calculated as find.

⁴⁴ See *supra* note 32.

plaintiff lawyers to reclassify pleural plaque claims as mild asbestosis claims. The MT soon experienced dramatic increases in the number of claims of unimpaired persons alleging 1/0 asbestosis, forcing it to decrease its payout to five cents on the dollars.

As reported by the MT Trust, “90% of the Trust’s last 200,000 claims have come from attorney sponsored x-ray screening programs. . . 91% of all claims against the Trust allege only non-malignant asbestos ‘disease,’ and. . . these cases currently receive 76% of all trust funds.”⁴⁵

One researcher has calculated that the MT may have paid \$190 million for unauthentic or inflated claims between 1996 and 2001.⁴⁶

Based upon my studies of fourteen asbestos bankruptcy trusts, I conclude that these trusts have failed to meet what is (or ought to be) their fundamental purpose: ensuring that the limited resources available from the estate of the bankrupt debtor are allocated fairly to persons who suffered actual injury caused by exposure to the debtor’s products. Instead, it is clear from my research that major portions of these assets have been diverted to the payment of claims of those without injury and those whose injuries were not caused by exposure to the debtors’ products, with as much as 40% of those payments going to plaintiff lawyers. These assets are being dissipated at the expense of the actual victims injured by exposure to the debtor’s products, who are being victimized a second time by the trusts’ failures. I attribute the asbestos bankruptcy trusts’ failures to five basic flaws:

⁴⁵ Letter from Steven Kazan to Honorable Jack B. Weinstein and the Honorable Burton Lifland, July 23, 2002 (reporting remarks by David Austern at an asbestos seminar), included as Attachment A to Judiciary Committee Asbestos Report, Remarks of Senator Kyl.

⁴⁶ See Roger Parloff, *Mass Tort Medicine Man*, *The American Lawyer*, Jan. 3, 2003.

- a) failure to provide for independent trustees and disinterested administrators;
- b) failure to establish appropriate medical criteria in the trust distribution procedures;
- c) failure to require reliable diagnoses of disease by independent qualified medical personnel;
- d) failure to require adequate evidence of exposure to debtors' products; and
- e) lack of appropriate and effective audit and oversight procedures.

Because of these flaws, bankruptcy trusts have been overwhelmed by hundreds of thousands of meritless claims, resulting in rapid dissipation of trust assets and loss of meaningful compensation for actual victims injured by exposure to debtors' asbestos-containing products.

The MT has been the model for enactment of §524(g) of the Bankruptcy Code and for the establishment of other asbestos bankruptcy trusts. The intrinsic flaws of the MT have thus been replicated both in legislation and in other bankruptcy trust practices. This represents a massive failure in civil justice administration. In the following sections, I will explore the dimensions of, and reasons for, this failure.

C. The Effect Of The Adoption Of Section 524(g) Of The Bankruptcy Code

In a conventional Chapter 11 case, a debtor files for bankruptcy in order to begin the process of negotiating with its creditors over a plan of reorganization. The end result is a reorganization plan which sets forth the recovery that each class of creditor or stockholder will receive and allows the company to emerge as a viable entity. For a reorganization plan to be adopted, it must normally be approved by a two-thirds majority of each class of affected creditors or stockholders. However, the bankruptcy court may approve a reorganization plan over the objection of a creditor or stockholder class if the court concludes that the plan is "fair and equitable" to the class. Parties entitled to vote

on a plan are identified through a process that requires all creditors to assert their claims by a court-designated “bar date.”⁴⁷ Claims not filed by that date are forfeited. In asbestos-related bankruptcies, the “bar date” takes on critical importance. This is so because asbestos-related diseases have long latency periods; many victims, therefore, do not know at the time of the bankruptcy that they will have claims to assert against that company and would thus be dispossessed of their claims upon manifestation of injury.

The early asbestos bankruptcies, beginning with the Manville Trust, generally solved the problem of these future claims by estimating the amount of these future claims and funding a trust with assets intended to provide those claimants with recoveries similar to those being received by current creditors. Because the trusts’ assets would include equity in the debtor, it was to the advantage of present claimants looking to the trust for payment that the company emerging from bankruptcy be insulated from future claimants. To accomplish this, bankruptcy courts issued “channeling injunctions,” which required future asbestos claimants to sue the trust rather than the reorganized company.

To resolve doubts about whether the bankruptcy courts’ inherent powers were broad enough to issue such a channeling injunction, in 1994, Congress created explicit statutory authority for channeling injunctions in asbestos cases: Section 524(g). One of its provisions -- with consequences that Congress could not have intended -- increased the usual two-thirds requirement to 75% of those claimants with allowed claims to be paid under the plan from the assets of the trust.⁴⁸ The legislative change did not directly address another section of the bankruptcy code which gives courts significant leverage in bringing parties to agreement on a plan of reorganization. As noted, under bankruptcy

⁴⁷ 11 U.S.C. § 3003(c)(3).

⁴⁸ 11 U.S.C. §524(g)(2)(B)(ii)(IV)(bb).

law, if one class votes the plan down, the plan can still take effect if the judges finds that it is “fair and equitable” – a process known as “cramdown.”⁴⁹ Cramdown limits the ability of a creditor group to hold up the bankruptcy to obtain a disproportionate and economically unjustified amount. It is the threat of cramdown that keeps parties honest, pressures them to resolve their differences at the bargaining table, and allows the company to reorganize without protracted delays. Bankruptcy courts appear to operate under the assumption that §524(g) exempts asbestos claimants from cramdown.⁵⁰ Exemption thus far from cramdown coupled with the 75% supermajority provision has drastically shifted the balance of forces vying for share of the debtor’s assets. From the moment an asbestos bankruptcy commences, it is an overriding reality that the company will not be able to emerge from bankruptcy unless the plaintiff lawyers representing the substantial portion of claimants approve of the restructuring plan. The same small cadre of plaintiff lawyers who appear in most asbestos bankruptcies have thus been vested with near complete and substantially unchecked power to dictate the terms of the plan. Every bankruptcy judge understands that this is so and with rare exception, accepts, adopts and otherwise ratifies whatever is needed to satisfy plaintiff lawyer demands, including grossly inflated demands⁵¹ and trust structures and trust distribution procedures that allow claims to be

⁴⁹ 11 U.S.C. §1129 (b).

⁵⁰ See *Walter v. Celotex*, 197 B.R. 372 (Bankr. M.D. Fla. 1996) (though not specifically addressing the cramdown point, the court agreed that Celotex’s attempt to circumvent the 75% voting requirement violated §524(g). The decision cites Ralph Mabey & Peter Zisser, *Improving Treatment of Future Claims: The Unfinished Business Left By The Manville Amendments*, 69 Am. Bankr. L.J. 487 (1995) which mentions in passing and without authority that §524(g) precludes cramdown. Though the court stated that “the determination as to the scope and the extent of a §524(g) injunction is limited to the determination of what was required by the [settlement agreement],” *id.* at 379, nonetheless, the decision is relied on by asbestos creditors to support their argument that §524(g) precludes cramdown.)

⁵¹ For example, plaintiff lawyers are demanding the enormous sum of 16 billion dollars as a condition for allowing Owens-Corning to emerge from bankruptcy. In the Federal-Mogul bankruptcy, they

paid without valid evidence of actual injury and without proof of actual exposure to the debtor's products.

This unbridled power is compounded by the perverse provision in §524(g) that the 75% requirement be met by the number of claimants with allowed claims to be paid under the plan, on a one-claimant-one-vote basis, not by the value of their claims. While plaintiff lawyers hardly need any additional stimulus to sponsor additional screenings in order to generate additional claimants – the overwhelming majority of which have no asbestos-related illness cognizable by medical science – this provision in §524(g) does just that. The more claimants lawyers can thus generate, the more control they can exert over the bankruptcy process and the more they can extract from the company in the way of a pre-petition “success fee” for facilitating the 75% approval. The perverseness of this provision is thus palpable. However incongruous it may be to contemplate that Congress is providing lawyers with rewards commensurate with the number of bogus legal claims that they can originate, that is exactly the outcome under §524(g) today. Under one-claimant-one-vote, a nonsick claimant who has been “diagnosed” by one of the plaintiff litigation doctors as having a condition “consistent with asbestosis” (though not with asbestosis), who has no lung impairment even under maladministered pulmonary function tests performed by a screening enterprises, has the same “one vote” as a claimant with mesothelioma, a gruesome and deadly disease with a value in the tort world of several million dollars. Since nonsick claimants outnumber and outvote malignant claimants and others who are actually ill by a ratio of 8-10:1, the latter typically end up shortchanged in the asset division by a wide margin. Section §524(g) as

are demanding over one billion dollars despite the fact that prepetition, the company's total payout for asbestos claims was less than twenty million dollars.

applied, thus favors the interests of the nonsick over the claims of those with malignancies. No members of Congress, not even card-carrying members of the American Trial Lawyers' Association, would knowingly vote to enshrine such a policy. Yet, by the law of unintended consequences, this is precisely the policy that Congress has adopted.

Section 524(g) also mandates that the reorganized company issue a majority of its voting stock to the trust established to pay claimants. The practical effect of this provision is that when the reorganized company emerges from bankruptcy, the corporate officers will be working for the plaintiff lawyers who control the bankruptcy and through their designees, the trustees of the trust, will control the majority of shares of the reorganized company. This has the obvious effect of deterring these officers from opposing plaintiff lawyers by, for example, seeking to restrict claiming eligibility against the trust to those with actual asbestos-related injuries that have resulted from exposure to the debtor's products.

What Congress has inadvertently created -- a perverse discriminatory process that promotes fraudulent claiming -- Congress should now correct.

D. Pre-Packaged Bankruptcies

Increasingly companies which are overwhelmed by asbestos litigation and facing insolvency, are resorting to pre-packaged bankruptcies ("pre-packs"). In a pre-pack, the Chapter 11 plan is negotiated between the attorneys for the asbestos claimants and the

debtor-to-be and voted on before the company files its bankruptcy petition.⁵² Usually, the court then holds a single hearing to determine whether the requirements of the Bankruptcy Code have been adhered to and whether the plan should be approved.⁵³

There is nothing inherently wrong with the concept of a pre-packaged bankruptcy filing. Indeed, pre-packs may be seen as a way to take advantage of the special “asbestos trust” and “channeling injunction” provisions of the Bankruptcy Code to efficiently provide fair compensation to individuals injured as a result of exposure to asbestos products in a process which minimizes litigation and transaction costs, expedites payments to claimants and preserves to the maximum extent possible, the debtor’s business and goodwill.⁵⁴ Indeed, companies that have resorted to pre-packs such as Shook & Fletcher Insulation Co., J.J. Thorpe Company and Combustion Engineering, Inc., indicate that they are doing so for purposes of fairness, efficiency and avoidance of delay.⁵⁵ Prepacks have also been filed by ACandS, Western Asbestos Co., Mid-Valley (involving certain Halliburton subsidiaries including DII Industries, LLC, formerly Dresser Industries, and Kellogg, Brown & Root), Utex and the Congoleum Corporation.⁵⁶ Despite the stated advantages and objectives of pre-packaged bankruptcy filings, the

⁵² See *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 224 n.5 (3d Cir. 2003) (distinguishing pre-packs from “pre-approved” bankruptcies and conventional bankruptcy cases); *In re NRG Energy, Inc.*, 294 B.R. 71, 82 (Bankr. D. Minn. 2003) (citing additional cases and articles on pre-packs generally).

⁵³ See generally, Mark D. Plevin et al., *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. Tex. L. Rev. 883 (2003) (hereinafter Plevin et al., *Pre-Packaged Asbestos Bankruptcies*).

⁵⁴ *Id.* at 889-91.

⁵⁵ *Id.*

⁵⁶ In the interest of full disclosure, I was retained for a short time as a potential expert witness on the history of asbestos litigation, formation of asbestos bankruptcy trusts and the effect of the proposed TDP with regard to the Congoleum bankruptcy. Other than reading the proposed Congoleum Plan and related documents, I did no other work.

practices that have developed reveal serious distortions and perversions of the bankruptcy process.

To illustrate how pre-packs actually come into being, I have extracted elements from various pre-packs that have been negotiated to create the following composite example:

1. A Pre-Pack Composite

Because of bankruptcies of companies that had provided a substantial portion of the cash flow realized by plaintiff lawyers, a former asbestos-containing product producer (“FAPP”) finds that plaintiff lawyers are no longer willing to settle 1/0 asbestosis claims for \$300 per claim, as they had been doing for several years and are now demanding \$1500 for such claims and proportionately higher amounts for seriously injured claimants. In addition, FAPP is being named as a defendant in an increasing number of cases.

FAPP’s *denouement* comes when it is taken to trial in a “magic” jurisdiction.⁵⁷ Though the three plaintiffs in that action have no asbestos-related injury recognized by medical science, have never sought medical treatment for their condition and have never missed a day of work due to adverse health, the jury awards each \$20,000,000. Plaintiff lawyers then approach FAPP and indicate they are willing to settle the verdicts at a discount but only if FAPP agrees to settle several hundred similar claims that are in plaintiff lawyer’s inventory. (The same scenario may occur where a single plaintiff with a malignant condition goes to trial in a “magic jurisdiction” and compensatory and punitive damages, for example, of \$50,000,000 are awarded. In that case, to settle the

⁵⁷ See Theories of Asbestos Litigation, *id.* at 39 n.17.

malignant claim, plaintiff lawyers require inclusion of scores or more of nonmalignant “unimpaired” claims.).

As a consequence of these recent verdicts and increased settlement demands, FAPP’s stock plunges, eliminating the value of stock options of officers and board members. FAPP has now also gotten the message that even though it has almost a billion dollars of insurance coverage remaining (though that is disputed by the insurance carriers), the quintupling of the price for settling claims coupled with a substantial increase in the number of claims, both realized and anticipated, will put its economic viability at risk. FAPP is then approached by plaintiff lawyers (or initiates the contact on its own) to discuss a global settlement of its asbestos liability. In the course of those negotiations, FAPP agrees to the following:

1) hire a law firm designated by plaintiff lawyers with which they frequently work in tandem to represent FAPP during the course of negotiations so as to “facilitate” those negotiations;

2) do a pre-packaged bankruptcy filing;

3) separately settle a large number of plaintiff lawyer’s pending cases for highly inflated values, to be paid out of its insurance coverage;⁵⁸

4) agree to a reorganization plan (“plan”) which is largely drafted by plaintiff lawyers and the law firms that FAPP hired at the “suggestion” of the plaintiff lawyer; and

5) pay a “success bonus” of \$20,000,000 to the plaintiff lawyer for obtaining the 75% claimant approval required to create a §524(g) trust.

⁵⁸ In a two part structure that has now become commonplace in pre-packaged asbestos bankruptcies, Congoleum has agreed to establish a prepetition trust funded by insurance proceeds to distribute funds in accordance with the terms of its settlement agreement with claimants and has granted that trust a security interest in its rights under applicable insurance coverage and payments from insurers for asbestos claims. Plevin et al., *Pre-packaged Asbestos Bankruptcies*, *id.* at 891-92.

As part of this plan which includes assignment of its remaining insurance coverage to the bankruptcy trust to be created, FAPP will be allowed to retain a substantial portion of its assets (but less than 50%)⁵⁹ as it emerges from bankruptcy.

FAPP is largely uninvolved in formulating the plan drawn up by its ostensible counsel and the plaintiff lawyers despite the fact that it allows claimants who have no injury recognized by medical science and who will not be required to present any proof of actual exposure to its products,⁶⁰ to be paid by the trust to which claims will be channeled. FAPP's indifference to the terms of the plan reflect the economy realities of the situation. It has no interest in whether the claims against the trust will be valid. Its only concern is to get the 75% claimant approval of the plan so that upon its emergence from bankruptcy, an injunction will issue channeling all claims for injury arising from alleged exposure to its products to the trust.⁶¹ To facilitate the 75% approval, as directed by the plaintiff's lawyer, FAPP agrees to pay (or to assign its insurance coverage to pay) 95% of the liquidated amounts of the separate highly inflated settlements of plaintiff lawyers' current inventories. By that artifice, which leaves a 5% unpaid stub, plaintiff lawyers will still be able to cast votes in favor of the plan for those claimants who have settled their claims but are being paid "only" 95% of those settlement amounts.⁶²

⁵⁹ 11 U.S.C. §524(g)(2)(B)(i)(III).

⁶⁰ The reorganization plan filed in the Congoleum bankruptcy allows claimants to file against the trust on the basis of minimal medical criteria by submitting the following exposure statement: "I [client's name], under penalty of perjury, state that I was exposed to an asbestos-containing product manufactured, sold or distributed by Congoleum or for which Congoleum has legal liability." Thus, someone who once walked across a Congoleum tile for one minute can honestly sign this statement to qualify for payment. Indeed, under the proposed plan, essentially anyone in the United States can qualify for payment so long as they can provide the most basic of medical information.

⁶¹ 11 U.S.C. §§524(g)(1)(A)-(B), 3, and 4.

⁶² In the "master settlement agreement" setting up the Combustion Engineering Settlement Trust, three classes of claims were created. One class was to be paid 95% of the agreed settlement amounts with

2. Pre-Packaged Asbestos Bankruptcies: An Assessment

The experience to date with pre-packaged asbestos-related bankruptcies is disturbing if not alarming. The points I raise below only touch upon a limited number of the most germane issues. On the basis of the research I have so far undertaken, it is manifest that a more complete study is called for. I therefore urge this Committee to commission such a study to determine whether the integrity of the bankruptcy process has been compromised by the practices that have developed with regard to pre-packaged asbestos bankruptcies.

1) An overriding purpose of the Bankruptcy Code is to treat like claimants alike.⁶³ However, because pre-pack negotiations take place in secret, select groups of claimants whose lawyers are part of or know about the negotiations are able to receive more favorable treatment than other similarly situated claimants. Such discriminatory actions would be objectionable in any context but are especially objectionable because some of the targets of the discrimination are persons who have suffered actual injury.⁶⁴

This was the case in the ACandS bankruptcy. There, Chief Judge Randall J. Newsome, to this point perhaps the sole bankruptcy judge apparently willing to incur the ire of plaintiffs lawyers by applying the requirements of the bankruptcy code to asbestos bankruptcies, struck down the prepackaged bankruptcy plan, stating:

the remaining 5% “stub” remaining as a claim to be asserted in the bankruptcy case. The second class was to be paid 85% with a 15% stub to be asserted in the bankruptcy case and the third class was to be paid 75% with a 25% stub remaining. Plevin et al., *Pre-Packaged Asbestos Bankruptcies*, *id.* at 900.

⁶³ “[A] plan shall. . . provide the same treatment for each claim or interest of a particular class. . . .” 11 U.S.C. §1123(a)(4).

⁶⁴ For example, in the Combustion Engineering matter, while the favored creditors – the overwhelming majority of which have no asbestos-caused illness recognized by medical science – have received a pre-petition payment as high as 95 cents on the dollar (plus an additional recovery in bankruptcy), cancer victims, 291 of whom are opposing the plan, as well as all future claimants, are to receive an estimated 18 cents on the dollars.

Section 524(g)(2)(B)(ii)(V) empowers the asbestos trust to manage present and future claims through various mechanisms, but those mechanisms must “provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve *similar claims in substantially the same manner.*” (Emphasis added.) The trust established in ACandS’ plan of reorganization does nothing of the kind. Not only does the plan discriminate between present and future claims, it pays similar claims in a totally disparate manner by giving preferential treatment to certain claimants who are secured by insurance proceeds. Those security interests were not granted based upon the medical condition of those claimants, but rather because, for whatever reason, they were first in line and able to carve out seemingly unassailable security interests. Nothing could be further from what the drafters of § 524(g) intended, as is evident from the legislative history. . . .

It is also impossible to conclude that this plan is imbued with fundamental fairness. Although the plan may meet the technical classification requirements of § 1122 and § 1129(b), it is fundamentally unfair that one claimant with non-symptomatic pleural plaques will be paid in full, while someone with mesothelioma runs the substantial risk of receiving nothing. Both should be compensated based on the nature of their injuries, not based on the influence and cunning of their lawyers. ***The court is informed that other judges have confirmed plans with such discriminatory classifications. This judge cannot do so in good conscience.***⁶⁵

2) The discriminatory treatment referred to by Judge Newsome is a common if not ubiquitous feature of pre-packaged bankruptcies. Usually, there is a pre-petition trust that pays a subset of current claimants nearly full value for their claims, followed by a post-petition trust that pays other current claimants and future claimants much smaller percentages of their claims, with significantly more stringent qualifying requirements.⁶⁶ This discriminatory treatment financially benefits the lawyers for the preferred claimants who typically charge contingency fees of 40 %. This benefit is spelled out in a recent law journal article:

⁶⁵ *In re ACandS, Inc., Debtor*, 2004 WL 1354283 (Bankr. D. Del) at *5-*6 (emphasis added).

⁶⁶ *See Plevin et al., Pre-packaged Asbestos Bankruptcies, id.* at 912.

Because their clients get paid more, and sooner, than other claimants, these lawyers personally benefit when the plan is structured in such a fashion. If the plan treated all claimants the same, paying all current claimants through the mechanism of a post-petition trust, the lawyers for the current claimants would make less money—even assuming the bankruptcy court or the trust made no effort to restrict the portion of a trust beneficiary’s payment that could be paid as a contingent fee. This, as much as anything, explains why asbestos pre-packs are structured in such a Byzantine fashion that is so different than any “conventional” asbestos bankruptcy case.⁶⁷

3) The realignment of interests in a prepackaged bankruptcy filing threatens the integrity of the bankruptcy process. The debtor, in some cases, is effectively coerced by the plaintiff lawyers to abdicate all responsibility for negotiating the plan and to join forces with the plaintiff lawyers to fund the trust solely or substantially with insurance coverage. Once again, it is Judge Newsome who has belled that cat:

The plan under consideration falls short. . . [of the required] standard [of good faith] in nearly every respect. Although ACandS was represented during the course of the prepackage negotiations, the correspondence among plaintiffs’ asbestos counsel presented at trial indicates that the plan was largely drafted by and for the benefit of the prepetition committee. It was the prepetition committee that drafted (or more likely directed debtor’s counsel in drafting) the prepetition trust, and apparently chose the trustee for the trust; it was the prepetition committee that decided how the security agreement would be crafted and how many classes of security interests would be formed; and it was the prepetition committee that decided who was going to get what. . . . ACandS was there to do their bidding, having been thrown overboard by Irex [its parent] to keep what was left of that company afloat. Given the unbridled dominance of the committee in the debtor’s affairs and actions during the prepetition period, its continued influence flowing from its majority status on the postpetition creditors committee, and the obvious self-dealing that resulted from control of the debtor, it is impossible to conclude that the plan was consistent with the objectives and purposes of the Bankruptcy Code.⁶⁸

⁶⁷ *Id.*

⁶⁸ *In re ACandS, id.* at *6.

4) Another consequence of a pre-packaged filing is that the number of claims will jump as plaintiff lawyers pile on in pursuit of trust assets. For example, in its pre-petition financial statement, Congoleum disclosed that before it started to pursue a pre-packaged plan, the company had an asbestos claim dismissal rate in the 60-90% range and that settled claims averaged about \$340.⁶⁹ In addition, its SEC disclosures projected the value of asbestos claims over the following fifty years to be in the \$53 to \$195 million range.⁷⁰ After announcing its intent to file a pre-packaged plan, the number of claims almost doubled and the company's estimate of total projected payments increased to approximately \$1 billion – virtually all of which was to be paid from insurance coverage.

5) The effects of the power conferred on plaintiff lawyers by §524(g) and interpretations of the Bankruptcy Code by bankruptcy courts are well illustrated in the prepackaged bankruptcy filing of Combustion Engineering. In that matter, the parent of Combustion Engineering agreed to pay Joe Rice of Motley Rice a “success fee” of \$20,000,000 for facilitating the filing. Since Rice presumably represented clients with claims against Combustion Engineering, he was, in effect, accepting a fee from the adversary of his clients for settling his clients' claims -- a glaringly unethical arrangement that has nonetheless received the approval of the U.S. District Court.⁷¹

6) In pre-packs, the debtor and the plaintiff lawyer together select a futures representative, arrange the terms of his compensation and retain the right to hire and fire him. While there is considerable reason to doubt that selection of a futures representative

⁶⁹ See Annual Report, Congoleum Corporation, 2001, at 8-9.

⁷⁰ See Asbestos Liability Summary Memo prepared for Congoleum by Ernst & Young at 2, March, 2002, included in Congoleum Summary Review Memorandum, Dec. 31, 2001, filed with the SEC.

⁷¹ See *infra* section VI.E.3.

in a conventional asbestos bankruptcy is a sufficient protection for future claimants,⁷² it is clear that in a prepackaged bankruptcy, the process is simply broken. In that circumstance, the futures representative is charged with negotiating with the same people who hired him and on whom he depends for his future employment. As a reward for “successfully” discharging his duties in the negotiation of the pre-packaged plan, plaintiff lawyers and debtors now in concert, will propose to the bankruptcy court that this hand-picked designee of the parties with interests fundamentally conflicting with those of future claimants, should be appointed by the bankruptcy court as the futures representative under the provisions of §524(g). That these courts then give their imprimatur is compelling evidence that bankruptcy courts and the U.S. Trustee are abdicating responsibility to exercise oversight over the selection of future claims representatives.

E. Conflicts of Interest

Conflicts of interest abound throughout asbestos litigation. In an article I am currently writing on the subject, I acknowledge that the effort I am undertaking to identify ethical issues in asbestos litigation may be largely academic . Indeed, if the reigning lawyers’ code of ethics, The Model Rules of Professional Conduct, were to be amended to include the provision: *These Rules shall not apply to asbestos litigation*, it is doubtful whether there would be a substantial change in current litigation practices.

⁷² See *infra* section VI.E.1.

Conflicts of interest arise in asbestos litigation because present as well as future claimants are competing for a finite and insufficient quantum of assets, and are therefore in effect, engaged in a zero-sum game. Accordingly, law firms which represent large numbers of asbestos claimants and which recruit new claimants who will be actively competing for limited resources simultaneously with the firm's current clients are violating Model Rule 1.7 by failing to secure the informed consent of both new and current clients to these conflicting engagements. Conflicts of interest are also created by the common practice of representation of a diverse disease mix. Nonetheless, courts and disciplinary authorities largely ignore conflicts of interest in asbestos litigation, even when the violations are egregious.⁷³

The conflicts of interest that abound in asbestos litigation exist in even greater profusion in the asbestos bankruptcy process. Here conflicts of interest are, at least in theory, subject to the special purview of both bankruptcy courts and the U.S. Trustee. Bankruptcy courts, however, largely ignore such conflicts, choosing expedient submission to the power exercised by plaintiff lawyers over exploration of conflicts and enforcement of the bankruptcy rules. While in significant measure, it is the role of the U.S. Trustee to inhibit conflicts of interest,⁷⁴ form creditors' committees and insist upon full disclosure of even potential conflicts, that role has been considerably diminished in practice. One reason is that the tort claimants that the U.S. Trustee appoints to the ACCs effectively resign their roles when they give their proxies to their attorneys, notwithstanding their own fiduciary duties to creditors. Plaintiff attorneys, who then constitute the ACC, have effectively overridden the U.S. Trustee's statutory obligation to

⁷³ See Theories of Asbestos Litigation, *id.* at 72 n.109.

⁷⁴ See 28 U.S.C. §586(a)(3)(H); *see also*, 11 U.S.C. § 307.

appoint ACC members. This displacement facilitates these attorneys' failure to disclose to the U.S. Trustee the conflicting interests that they represent.

While a full treatment of conflicts of interest in asbestos bankruptcy is not possible within the time constraints under which I am operating, the following recitation should be sufficient to alert this Committee and the U.S. Trustee, as well, of some of the principal conflicts.

As already noted, the same law firms that represent the large majority of asbestos claimants also represent the majority of claimants in bankruptcy proceedings.⁷⁵ Among the claimant/creditors these law firms represent in a bankruptcy, a relatively small percent list malignancies such as mesothelioma, lung cancer and other cancers. The large majority allege pleural plaques and mild (1/0) asbestosis. These nonmalignant claims include both those alleging impairment on the basis of pulmonary function tests typically administered during attorney-sponsored asbestos screenings,⁷⁶ and those who do not allege impairment -- the so-called "unimpaireds." Because of the zero-sum nature of the bankruptcy process, each grouping of claimants has differing interests. In particular, the malignant subgroups (mesothelioma, lung cancers and other cancers) have interests which conflict with the nonmalignant subgroups. These conflicts of interest are magnified by the routine failure to comply with Bankruptcy Rule 2019(a) which requires that any entity purporting to represent more than one creditor in a Chapter 11 case "shall

⁷⁵ A memorandum filed in the Owens Corning ("OC") bankruptcy estimates that the handful of law firms listed above represent over 100,000 asbestos claimants in the OC bankruptcy proceeding. Moreover, prior to the filing of the OC bankruptcy, approximately 111 law firms said that they represented approximately 235,000 claimants; of these, 10 law firms represented approximately 120,000 of these claimants. *See* Memorandum In Support of Motion For Structural Relief Required To Eradicate the Legal Ethical Conflicts of Asbestos Law Firms (filed by Official Committee of Unsecured Creditors), Oct. 24 2003, In Re Owens Corning et al., U.S. Bankr. Ct., D. Del., Case No. 00-03837 (JKF).

⁷⁶ For a discussion of such testing, *see* Brickman, Theories of Asbestos Litigation, *id.* at 111-28.

file a verified statement” listing the name and address of each creditor and the nature and amount of each creditor’s claim.⁷⁷

In addition to conflicts of interest between current claimants represented by the same law firms, there are also conflicts of interest resulting from the representation of those current claimants while at the same time actively recruiting new claimants to compete for the limited resources. The U.S. Supreme Court held in *Amchem Products v. Windsor*,⁷⁸ that class members were deprived of adequate representation by class counsel in a mega-asbestos settlement because of intra-class conflicts of interest between currently injured class members and future claimants not yet identified. There had to be, said the Court, “structural assurance of fair and adequate representation for the diverse groups. . . affected.”⁷⁹ Moreover, in another mega-asbestos settlement struck down by the U.S. Supreme Court, *Ortiz v. Fibreboard*,⁸⁰ the court held that class counsel’s inventory settlement on different and more favorable terms than those provided in the proposed class action settlement for future claimants constituted a concurrent conflict of

⁷⁷ Rule 2019(a) provides:

(a) Data required. In a chapter 9 municipality or chapter 11 reorganization case, except with respect to a committee appointed pursuant to §1102 or 1114 of the Code, every entity or committee representing more than one creditor or equity security holder and, unless otherwise directed by the court, every indenture trustee, shall file a verified statement setting forth (1) the name and address of the creditor or equity security holder; (2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity. . . . The statement shall include a copy of the instrument, if any, whereby the entity, committee, or indenture trustee is empowered to act on behalf of creditors or equity security holders. A supplemental statement shall be filed promptly, setting forth any material changes in the facts contained in the statement filed pursuant to this subdivision.
Fed. R. Bankr. 2019(A).

⁷⁸ 521 U.S. 591 (1997).

⁷⁹ 521 U.S. at 594.

⁸⁰ 11 S.Ct. 2295 (1999).

interest. Applying these holdings to the bankruptcy context leads to the conclusion that because one subgroup's gains are at the expense of other subgroups, law firms may not simultaneously represent different subgroups in the same bankruptcy proceeding. That is, they cannot represent both malignant and nonmalignant claimants in the same bankruptcy proceeding because these subgroups are competing for a limited share of the same assets. In addition, they cannot represent both present claimant/creditors and future claimants who will seek compensation from the 524(g) trust. As stated in *Ortiz*, there has to be both structural protection of independent representation for subclasses with conflicting interests and also separate counsel to eliminate conflicting interests of counsel.⁸¹

Despite these conflicts of interest, these law firms nonetheless negotiate the “proper” allocation of limited funds among the conflicting inventory subgroups, unimpeded by actions of the bankruptcy court or of the U.S. Trustee. These conflicts of interest are compounded by the voting process that takes place to establish the 524(g) trust. The same relative handful of law firms that reached a conclusion as to how to allocate funds among the conflicting subgroups, thus denominating some of their clients as winners in the zero-sum game and others--who consequently received less--as losers, then go on to exercise the proxies they state that they have been granted to cast claimants' votes in favor of the plan, thus allowing the creation of the 524(g) trust. But these voting

⁸¹ *Ortiz, id.*. Cf. Maryland Bar Ass'n Ethics Opinion 2003-10. The Opinion responds to the follow facts. Lawyer represents asbestos clients in suits against defendants A, B and C. A filed for bankruptcy under Chapter 11 and the creditors committee asked Lawyer to be the Futures Representative. To resolve any conflict, Lawyer announced that he would no longer represent clients suing A but would continue to represent his clients suing B and C. The Bar Ass'n opined that Lawyer's proposed action would not cure the conflict and would still violate Rule 1.7, stating: Lawyer's obligations to the futures “(to preserve as much of the ‘pie’ for these future claimants) will necessarily require [that lawyer] to advocate against [present claimants whom Lawyer still represented against other asbestos defendants] (who themselves want as large a piece of the ‘pie’ from [the debtor] as they may be able to obtain.” Op. 2003-10, at 6-7.

rights which the law firms state have been delegated to them by their clients are fiduciary in nature, i.e., the firms have been entrusted with clients' rights which must be exercised in favor of each clients' fiducial rights. Moreover, under *Ortiz*, the law firms cannot represent conflicting interests. How then can they advise their multiple malignant, nonmalignant and unimpaired clients with conflicting interests, how to instruct their own counsel to vote to apportion the limited funds? The conflicts of interest and breaches of fiduciary obligation are further compounded by the fact that the attorneys claiming client proxies to vote on the 524(g) plan fail to disclose both to their clients, the tort claimants designated by the U.S. Trustee to sit on the ACCs, and to the U.S. Trustee, that they sit on multiple ACCs in other asbestos bankruptcies where there exists substantial contribution or indemnification claims against, or obligations to, the debtor's estate. These incestuous interlocking directorates would be illegal in other contexts and are especially corrosive in the asbestos bankruptcy context. A law firm which represents an ACC in a Chapter 11 case of one asbestos defendant would appear to have a diminished interest in having that debtor pursue contribution or indemnity claims against, or argue for the allocation of asbestos liability to, a second asbestos defendant in bankruptcy where that same lawyer also represents the ACC in that second bankruptcy where that firm's fee interest is enhanced more by the second bankruptcy than by the first.⁸²

An additional conflict of interest exists in the case of the law firms that entered into the National Settlement Programs agreements (NSP) with Owens Corning setting forth specific amounts for various types of injury that Owens Corning would pay to

⁸² These conflicts of interest are highlighted by a recent motion in the Owens Corning bankruptcy in which Owens Corning and Babcock & Wilcox propose, *inter alia*, to "wash" their contribution and indemnity claims. There are six overlapping ACC members in the two bankruptcies. In addition, the Analysis Research Planning Corp., a claims estimation expert frequently retained in asbestos bankruptcies and accommodative of plaintiff lawyers' interests, is the claims expert both for Owens Corning and for the Babcock & Wilcox FCR.

claimants. Under the terms of these agreements, most of the firms agreed to recommend to their clients that they agree to accept these specified amounts in settlement of their claims. Claimants who accepted the standing Owens Corning offer and signed releases accepted by Owens Corning thus entered into contracts with Owens Corning. Those contracting claimants who had not yet received the contractually specified amounts when Owens Corning filed for bankruptcy, had fixed liquidated claims against the debtor equivalent in most respects to the claims of commercial debt holders evidenced by debentures or notes. In fact, Owens Corning acknowledged that there were 61,000 such asbestos claimants.

After Owens Corning filed for bankruptcy in 2000, these same law firms also represent persons who rejected Owens Corning's offer as well as other asbestos claimants asserting "unliquidated and contingent tort claims." The conflicts of interest between the contract claimants and the contingent tort claimants is manifest. Contract claimants' interests are to minimize the value of the unliquidated claims in order to maximize their own pro rata recoveries. This would include demonstrating that the contingent tort claimants did not have valid claims under state law, that they had no actual injury or that exposure to Owens Corning products was not a substantial factor in causing any asbestos-related injury that they did have. At the same time, these law firms had a duty of loyalty to the contingent tort claimants to obtain the maximum recovery possible. Moreover, since the payments received by those who settled and signed the releases may be preferential and therefore avoidable, it is incumbent on plaintiff lawyers who not only represent these claimants but also those with liquidated and unliquidated claims against the debtor to so disclose this possibility. For example, clients represented by these lawyers who did not receive avoidable payments would potentially benefit from the

recovery of the avoidable payments received by those who signed the releases. The conflict is further exacerbated when the attorney who represents clients who have received avoidable payments and who has himself received a percentage of these payments as fees -- itself a possibly preferential or otherwise avoidable payment -- is given a proxy to sit on an ACC on behalf of a client who did not receive such payments, without disclosing that conflict to the client or the fact that the attorney will seek to obtain a release of any avoidance claims against him -- contrary to the interests of the ACC appointees that the attorney represents.

1. Does The Appointment Of A Futures Representative Cure The Temporal Conflict?

I have already pointed out the inherent conflicts of interest that exist when a future claims representative is appointed by the parties in a pre-packaged bankruptcy.⁸³

In a regular bankruptcy filing, Futures Claims Representatives (“FCR”), who negotiate a share of the assets to go into the trust on behalf of future claimants, are nominally selected by the debtor. In fact, plaintiff attorneys usually play a dominant role in that selection process. Appointments to the position of FCR are lucrative. Moreover, a number of FCRs serve in that capacity in multiple trusts.⁸⁴ Some FCRs openly vie for appointment as the FCR in other asbestos bankruptcies. To be so selected, however, they need the support of the entity which exercises the most influence on the selection process: the plaintiff attorney. It is no surprise, therefore, that FCRs rarely take positions

⁸³ See *supra* section VI.D.2 (6).

⁸⁴ See, e.g., Testimony of Professor Eric D. Green, Senate Committee On The Judiciary, on S.1125, June 4, 2003 (indicating that Professor Green is the FCR in the Fuller-Austin, Federal-Mogul and Babcock & Wilcox bankruptcies.)

inconsistent with the interests of the plaintiff attorneys that control the bankruptcy process.

Because of the lucrative nature of the position, FCRs have a vital interest in the perpetuation of the status quo, especially in light of proposed legislation that would eliminate the asbestos bankruptcy trust, transferring all trusts' assets to a mechanism created by the legislation.⁸⁵ The effect of the self-interest of FCRs in the administration of asbestos bankruptcy trusts should be addressed in the course of the examination that I am advocating.

Finally, even though appointment of an FCR satisfies the §524(g) requirement and appears facially responsive to the holding in *Ortiz*, conflicts of interest nonetheless endure. For example, it is common in asbestos bankruptcies to divide future claimants into five to eight subgroups ranging from the unimpaired to those with mesothelioma. Each subgroup has different applicable evidentiary requirements and different dollar amounts or ranges of dollar amounts. These dollar values which are listed in the TDP, or the Matrix that is part of the TDP, in effect represent allocations of the limited funds set aside for the future claimants among competing subgroups. It is doubtful that a single person, the Future Representative, can adequately represent the conflicting interests of each of the following subgroups: unimpaired asbestotic and pleural plaque claimants; impaired asbestotic claimants; asbestotic claimants with an ILO grade of 2/1 or higher; mesothelioma claimants; lung cancer claimants; and other future cancer claimants. To comply with the Supreme Court's holding in *Ortiz*, each subgroup of future claimants would have to have separate representation. As stated by the Second Circuit:

⁸⁵ For a brief description of the testimony of the designated FCR to represent FCR interests, purporting to support the idea of a legislative solution but recommending changes that would make any bill impassable, *see infra* note 111.

Within the category of health claimants, marked differences exist between identifiable sub-groups that require division of health claimants themselves into appropriate subclasses.

[W]here differences among members of a class are such that subclasses must be established, we know of no authority that permits a court to approve a settlement without creating subclasses on the basis of consents by members of a unitary class, some of whom happen to be members of the distinct sub-groups. The class representatives may well have thought that the Settlement serves the aggregate interests of the entire class. *But the adversity among sub-groups requires that the member of each sub-group cannot be bound by a settlement except by consents given by those who understand that their role is to represent solely the members of their respective sub-groups.*⁸⁶

The Second Circuit's analysis was substantially adopted by the Third Circuit in rejecting the *Amchem* asbestos settlement.⁸⁷ The Third Circuit ruled that certifying a unitary class of asbestos claimants, including present and future claimants with such conflicting interests, was improper because the conflicts "preclude[d] a finding of adequacy of representation. . . . Absent structural protections to assure that differently situated plaintiffs negotiate for their own unique interests, the fact that plaintiffs of different types were among the named plaintiffs does not rectify the conflict."⁸⁸

The Third Circuit's opinion which largely incorporated the Second Circuit's analysis, was adopted by the Supreme Court in rejecting the *Amchem* and *Ortiz* asbestos settlements. Both settlements had included claimants with widely conflicting interests in

⁸⁶ In re Joint E. and S. Dist. Asbestos Litig., 982 F.2d 721, 741, 743 (2d Cir. 1992) (emphasis added); *modified on other grounds*, 993 F.2d 7 (2d Cir. 1993).

⁸⁷ See *Georgine v. Amchem Products, Inc.* 83 F.3d 610, 631 (3d Cir. 1996), *aff'd sub nom.*, *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997).

⁸⁸ *Id.* at 631.

a unitary class represented by a single representative or undifferentiated group of representatives; both lacked the structural assurance of fair and adequate representation of groups with conflicting interests.⁸⁹

2. The Role Of Gilbert Heinz In Prepackaged Bankruptcies

Gilbert Heinz (“GH”) is a law firm which devotes a significant part of its practice to representing asbestos tort claimants. The firm owns 70% of The Kenesis Group, which does claim processing for asbestos trusts.⁹⁰ GH has been retained by the defendant/debtor in a number of prepackaged asbestos bankruptcies, upon the suggestion of plaintiff law firms Weitz & Luxenberg and Motley Rice, to help facilitate the arrangement.⁹¹ GH also represents or is co-counsel to asbestos claimants asserting claims against the companies that retained the firm to facilitate the pre-packaged bankruptcies. GH is thus representing conflicting interests in violation of Model Rule 1.7(a)(1).⁹² Nonetheless, the bankruptcy court in the Congoleum bankruptcy granted the debtor’s application to retain GH as its counsel, accepting GH’s argument that the “current client”

⁸⁹ See *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 627-28 (1997) (extensively quoting Second Circuit opinion and stating that “the settling parties, in sum, achieved a global compromise with no structural assurance of fair and adequate representation for the diverse groups and individuals affected. Although the named parties alleged a range of complaints, each served generally as representative for the whole, not for a separate constituency”); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 857-59 (1999) (a unitary class with widely conflicting interests among the subgroups precludes finding of adequacy of representation).

⁹⁰ For a discussion of Kenesis, see *infra* nn.115 et seq.

⁹¹ The GH/Weitz/Rice team collaborated to arrange the pre-packaged bankruptcies of ACandS, JT Thorpe, Shook & Fletcher and Congoleum.

⁹² ABA Model Rules of Professional Conduct, R. 1.7(a)(1).

prohibition in Rule 1.7(a)(1) is limited to adverse positions “in the same matter.”

Prevailing interpretations of this rule of ethics, however, are to the contrary.⁹³

Because of its numerous financial ties to major plaintiff asbestos firms, GH may also be violating Model Rule 1.7(a)(2), which prohibits a lawyer, absent informed consent, to represent a client if “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.”⁹⁴ The bankruptcy court’s decision in *Congoleum* is indicative of the lengths that bankruptcy courts will go to accommodate the interests of plaintiff lawyers in asbestos bankruptcies.

3. The Role Of Joe Rice In The Combustion Engineering Bankruptcy

Joe Rice, of the firm of Motley Rice, is one of the leading plaintiff asbestos lawyers in the country. He negotiated the terms of the Combustion Engineering pre-packaged bankruptcy agreement with ABB Ltd., the parent of Combustion. ABB agreed to pay Rice a “success fee” of \$20,000,000 for obtaining the requisite 75% claimants’ vote in favor of the Combustion Engineering (“CE”) Master Settlement Agreement (“MSA”).⁹⁵ While the bankruptcy court determined that this fee was not subject to the approval of the court, it held that it had equitable power to protect the process since Rice had “an actual conflict of interest in the case [because h]e is being paid \$20 million by

⁹³ See ABA Model Rule 1.7, cmt 6 (2004) (“absent consent, a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated.”); see also, Geoffrey Hazard and William Hodes, *THE LAW OF LAWYERING*, §1.7:203 (interpreting Rule 1.7(a) as prohibiting a lawyer’s representation of adverse interests even where the matters are wholly unrelated).

⁹⁴ ABA Model Rules of Prof. Conduct, Rule 1.7(a)(2) (2004).

⁹⁵ See Alex Berenson, *A Cauldron Of Ethics And Asbestos*, N.Y. Times, March 12, 2003 at C1.

the parent of an entity he is suing. In addition, he has tort clients who have claims against Debtor. . . and he has contingency fee agreements with those clients who will be or have been paid through the CE Settlement Trust. . . and/or by the Asbestos PI Trust.”⁹⁶

Under that equitable power, the court determined that Rice would have to return any amount of the fee paid and waive any unpaid amount unless he informed his clients of the existence and nature of the conflict and obtained written waivers from these clients.⁹⁷

Nonetheless, despite the conflict of interest and the requirements of the Bankruptcy Code, the bankruptcy court approved the plan.⁹⁸

Apparently seeking to keep his “success fee” from being disclosed to his clients, Rice appealed. The district court vacated that portion of the bankruptcy court’s confirmation order concerning the “Claimants’ Representative’s” success fee, concluding that the bankruptcy court lacked subject matter jurisdiction over the “Claimants’ Representative’s” “private, contractual relationship between himself and his *asbestos plaintiff clients*. . . .”⁹⁹ While it is true that Rice argued that he was acting only on behalf of his own clients and not on behalf of all asbestos claimants affected by the MSA, the Disclosure Statement refers to Rice as “Claimants’ Representative.”¹⁰⁰ Moreover, the

⁹⁶ *In re Combustion Eng’g, Inc.* 295 B.R. 459, 478 (Bankr. D.Del. 2003).

⁹⁷ *Id.* Despite finding a conflict and further finding considerable uncertainty as to just whom Rice was representing as well as misrepresentation by Rice of his role as “Claimants Representative,” *id.* at 478, the bankruptcy court concluded that it could not compel repayment or waiver, *id.* at 479; it further held that “the prepetition vote was not tainted under the unusual circumstances of this case,” *id.* at 47 and that “there was no prejudice created by the misrepresentation that Mr. Rice was Claimants’ Representative.” *Id.* at 479.

⁹⁸ Since the plan was largely negotiated by a “Claimants’ Representative” with an actual conflict of interest who was to receive improper payments from the debtor’s parent, it is difficult to perceive how the court confirmed the plan in light of 11 U.S.C. §1129(a)(1)-(4).

⁹⁹ *See* Opinion and Order, *In re Combustion Eng’g, Inc.* (D. Del. Sept. 15, 2003) (Bankr. No. 03-10495 (JKF), Dist. No. 03-755 (AMW) (emphasis added).

bankruptcy court held that Rice could not have been retained as a Claimants' Representative because he had a conflict of interest as to the estate due to his employment and payment by Debtor's parent which is a creditor of Debtor.¹⁰¹ Furthermore, the "success fee" was not being paid by the claimants that he represented but by the parent of the debtor. If the district court's ruling is to the effect that the fee was, in actuality, a private contractual matter with his clients, then it effectively recognized that the \$20,000,000 would have been available to have been added to the trust to pay claimants had it not been paid to Rice – making it all the more bizarre that the district court gave its effective imprimatur to the fee. The fee arrangement was also unethical in that Rice was being paid part of his fee by the adversary of his client (the parent of the debtor-to-be, which was providing most of the funding of the trust) without the express knowledge and informed consent of his clients.¹⁰²

Time does not permit further elaboration of the amorphous if not troubling matter of just whom Rice represented in the CE bankruptcy. In a number of other bankruptcy proceedings, Rice has testified that though he and another attorney represented 75% of the asbestos claimants, he did not purport to "speak for" the claimants when he appeared before the court.¹⁰³ Moreover, despite repeated demands that he and other plaintiff counsel comply with Rule 2019¹⁰⁴ and list the names and addresses of their creditor/clients and the nature and amount of their claims, Rice and others have

¹⁰⁰ 295 B.R. at 478.

¹⁰¹ 295 B.R. 478 citing to Fed. R. Bankr. P. 2014.

¹⁰² Model Rules of Professional Conduct, R. 1.8(f).

¹⁰³ See Motion To Compel The Law Firm of Motley Rice LLC To Comply With Its Obligation Under Federal Rule of Bankruptcy Procedure 2019, July 6, 2004, *In re Congoleum Corp. et al.*, Case No. 03-51524 (KCF) (Bankr. D. N.J.).

¹⁰⁴ See *supra* note 77.

repeatedly failed to do so.¹⁰⁵ The purpose of Rule 2019 is to further the Bankruptcy Code's goal of complete disclosure and to ensure that lawyers adhere to ethical standards.¹⁰⁶ This includes disclosure of conflicts of interest so that bankruptcy courts can take prompt action to prevent such conflicts. The consistent failure by plaintiff attorneys to comply with Rule 2019 in asbestos bankruptcies facilitates the continuation of conflicts of interest in bankruptcy proceedings.

Finally, circumstances surrounding the district court's reversal of the bankruptcy court's requirement that Rice obtain the informed consent of his clients before he could receive the \$20,000,000 "success fee" raise an appearance of impropriety that should be addressed both by appointment of a special examiner by the bankruptcy court or the U.S. Trustee to inquire into the matter as well as the commissioning of an investigation by this Committee. These circumstances also involve the roles of Professor Francis McGovern as Mediator and Advisor in the Owens Corning bankruptcy as well as other positions held by Professor McGovern.

U.S. District Court Judge Alfred Wolin appointed Professor McGovern and four others as Advisors in December 2001 to assist him in overseeing the bankruptcies of Owens Corning, W.R. Grace, USG, Federal Mogul and Armstrong World Industries. Because two of these Advisors, Judson Hamlin and David Gross, also served as class counsel for asbestos cases in the G-I Holdings bankruptcy and because legal rulings by Judge Wolin could serve as a precedent for the G-I Holdings bankruptcy in which these advisors had a financial interest, thereby giving rise to a conflict of interest, and further because of numerous *ex parte* meetings that Judge Wolin had with his Advisors and

¹⁰⁵ See Motion To Compel, *id.*

¹⁰⁶ See *In re CF Holding Corp.*, 145 B.R. 124, 126-27 (Bankr. D. Conn. 1992.)

interested parties, the Third Circuit Court of Appeals issued a writ of mandamus to disqualify Judge Wolin from three of the bankruptcies. As members of this Committee are aware, this is an extraordinary remedy, only granted upon a finding of clear and indisputable evidence that a reasonable person, with knowledge of all the facts, would conclude that a judge's impartiality might reasonably be questioned.

Professor McGovern was later appointed as a Mediator in the Owens Corning bankruptcy. Professor McGovern had also served as a Trustee of both the Fibreboard Asbestos Compensation Trust (now the Fibreboard Settlement Trust) and the Celotex Asbestos Settlement Trust. Joe Rice and other plaintiff lawyers on the ACCs were responsible for Professor McGovern's appointments in those cases.¹⁰⁷ It appears that Professor McGovern may have continued to serve as Trustee of the Fibreboard Settlement Trust long after Owens Corning had acquired Fibreboard in 1997 and perhaps as late as 2001 when Judge Wolin appointed him as Advisor. It further appears that Professor McGovern's activities as Mediator included negotiation of a plan that transferred \$140 million of Owens Corning's assets to the Fibreboard Settlement Trust – a development favorable to the interests of Rice and the other plaintiff attorneys.

While Professor McGovern was involved in his role as Mediator in the Owens Corning bankruptcy, he was employed by ABB, the parent of Combustion Engineering, to be a private mediator of Combustion Engineering's pre-packaged plan.¹⁰⁸ At the time he was hired by ABB, Rice was not involved in the deliberations. Rice was later engaged to put together a pre-packaged bankruptcy deal.¹⁰⁹ McGovern was present at a meeting

¹⁰⁷ Deposition of Francis McGovern at 57, July 8, 2003, *In re* The Celotex Corporation.

¹⁰⁸ *Id.* at 141.

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¹⁰⁹ *Id.* at 148-149.

in Zurich with ABB and Joe Rice when the offer of a \$20,000,000 “success fee” was made and accepted.¹¹⁰ When asked whether he had contacted Rice as part of his mediation effort for ABB, whether he had traveled to Zurich with Rice, and whether he had discussed Rice’s compensation with Rice, Professor McGovern refused to answer, claiming these facts were confidential.¹¹¹

On September 10, 2003, after the bankruptcy court found Rice’s unconsented \$20 million fee unethical because of an “actual conflict of interest” with his clients, and while the matter was on appeal to Judge Wolin, Rice participated in a six hour, *ex parte* meeting with Judge Wolin, Professor McGovern, Gross and other plaintiff counsel.¹¹² Little is known about the details of this meeting. Professor McGovern, when deposed less than four months later, said he did not remember what had occurred.¹¹³

¹¹⁰ *Id.* at 147-49.

¹¹¹ *Id.* at 146-49. Professor McGovern has also played a role in coordinating the position of the FCRs with respect to S.1125, the Fairness in Asbestos Resolution Act of 2003, *see supra* note 84, though he was not an FCR in any of the asbestos bankruptcies. Professor McGovern’s coordinating role is revealed in a communication from Professor Green to other FCRs that had apparently been meeting periodically to coordinate their position with respect to S.1125:

Our beloved mentor and mediator Francis teaches on Mondays and therefore has kindly asked whether we can find another day for our next futures rep meeting. I am trying to schedule ASAP because of developments in many of the bankruptcies and the possibility that there could be some sudden and unpredictable activity on the legislation after Labor Day.

Email from Eric Green, Federal-Mogul Futures Representative, to other futures representatives, August 7, 2003. Since S.1125 would have dismantled the existing trusts and transferred its assets to the Act’s funding mechanism, FCRs would have seen their position eliminated. Professor Eric Green, the FCR in three of the bankruptcies acknowledged so in his testimony before Congress expressing the view of the FCRs. *See* Testimony of Professor Green, *id.* While Professor Green expressed the FCRs support for “a national legislative resolution to the asbestos litigation crisis,” *id.*, he advocated changes to the bill that would escalated the costs of the legislative resolution to levels unacceptable to the paying parties (defendants and insurers). At no point in his testimony did Professor Green acknowledge the specious nature of the overwhelming majority of present and future asbestos claims.

¹¹² Time Entry of David R. Gross, September 10, 2003. Judge Wolin’s log refers to this meeting as a session with “Francis and the boys” – the latter a term he used to refer to Rice and other leading plaintiffs’ attorneys with whom the periodically met *ex parte*.

¹¹³ *See* Deposition of Francis McGovern, at 66.

Five days after this *ex parte* meeting, on September 15, 2003, Judge Wolin reversed the bankruptcy court's order regarding the \$20,000,000 fee, relieving Rice of the obligation to notify his clients of the conflict of interest and obtain waivers or, in lieu thereof, disgorge his fee. Though Judge Wolin barred any inquiry into Professor McGovern's role in the Combustion Engineering case, there is evidence that Judge Wolin did in fact discuss the CE pre-packaged plan with Professor McGovern and his other Advisors both before and after CE filed for Chapter 11.¹¹⁴

The September 10, 2003 *ex parte* meeting was followed approximately two weeks later by another ruling by Judge Wolin staying a \$2.4 million disgorgement order of Judge Newsome against the Kinesis Group, LLC ("Kenesis").¹¹⁵ The Kenesis group is a claims processing firm 70% owned by Gilbert Heinz, the law firm hired by the debtor in the ACandS pre-packaged bankruptcy filing which works closely with plaintiff law firms involved in asbestos litigation and bankruptcies, including Motley Rice and Weitz & Luxenberg.¹¹⁶ Kenesis was to be paid \$3 million to do postpetition claims processing. Kenesis, in turn, subcontracted two thirds of that work to and paid approximately \$2 million to another entity which was owned by a paralegal on leave from employment at Rice's law firm but using the firm as her address. Under this arrangement, it appears that the Rice firm's paralegal was determining the eligibility of claims submitted by Rice's law firm on behalf of its clients for payment from the ACandS settlement trust. This

¹¹⁴ See Motion of Kensington Int'l Ltd., et al. pursuant to 11 U.S.C. §§105 and 327 and Delaware Local Bankruptcy Rule 9019 For Order Disqualifying And Terminating Appointment of Francis E. McGovern As Mediator In These Chapter 11 Cases, at ¶ 34, May 24, 2004, *In re Owens Corning*, No. 00-03837 (JKF), (Bankr. D. Del.).

¹¹⁵ The following recitation of facts about Kenesis is taken from Memorandum of the United States Trustee In Support of Objection To Debtor's Application To Employ the Kenesis Group, Aug. 7, 2003, *In re ACandS, Inc.*, No. 02-12687 (RJN) (Bankr. D. Del. 2003).

¹¹⁶ See *supra* section VI.E.2.

example of potential self-dealing apparently appears to merely scratch the surface of self-dealing in bankruptcy trust administration.

Given the circumstances described above with reference to Kenesis's subcontracting claims processing to a paralegal on leave from Rice's law firm, Judge Wolin's stay of Judge Newsome's order to disgorge the \$2.4 million so far paid to Kenesis,¹¹⁷ despite numerous violations of the Bankruptcy Code,¹¹⁸ would appear to have been favorable to Rice.

The recounting of those events and circumstances raises at least an appearance of impropriety. Professor McGovern's statement to the press that during the course of performing his duties, he saw "bad things going on. . . ."¹¹⁹ amplifies this appearance. To protect the integrity of the bankruptcy process and to provide assurance to capital markets and to the public that asbestos bankruptcy proceedings have not been corrupted, the U.S. Trustee should be encouraged to appoint a special examiner to investigate these events and to depose all relevant parties. In addition, this Committee should exercise its oversight responsibility to assure that such an investigation is undertaken and carried out with appropriate vigor.

¹¹⁷ Findings of Fact, Opinion And Conclusions of Law Re: Debtor's Motion To Employ The Kenesis Group, LLC, Aug. 25, 2003, *In re ACandS, Inc.* Case No. 02-12687(RJN) (Bankr. D. Del.)

¹¹⁸ See Memorandum of the U.S. Trustee, *id.* at 6-13.

¹¹⁹ *Supra* note 5.

E. Issues In Bankruptcy Trust Administration

While I have pointed out a number of issues of concern with respect to administration of the bankruptcy trusts, including the issue of the lack of independence of the trustees – most of whom are hand picked by plaintiff lawyers¹²⁰ -- there is another matter of concern that I wish to bring to this Committee's attention.

As I have noted above, evidence of exposure in asbestos litigation is often questionable at best. However, that evidence is often weighty indeed when compared with the evidence of exposure required to be submitted to the §524(g) bankruptcy trusts to establish a claim.¹²¹ In the course of my research, I have determined that exposure claims submitted on behalf of claimants to bankruptcy trusts may include conflicting assertions. That is, plaintiff lawyers may be asserting that a claimant had exposure to certain products at a certain work location for a certain time period when making a claim to trust A, and then for the same plaintiff, they are asserting an inconsistent work history and exposure statement to trust B, and so on.

Circumstantial evidence in support of this proposition exists in the form of “the path not taken.” All asbestos bankruptcy trusts have as part of the trust's plan, a trust distribution procedure (“TDP”). The TDP (and sometimes an accompanying matrix) sets forth the parameters for claiming against the trust, the evidence required for submission of a claim including the required medical and exposure evidence, the prescribed value of certain claims, and the percent of that value that the trust will pay. Since most claims submitted to one bankruptcy trust are submitted to other trusts as well, one would expect

¹²⁰ While this is generally true, in a few instances such as the Manville Trust and in the Mid-Valley bankruptcy of the Halliburton subsidiaries, independent trustees have been selected.

¹²¹ See *e.g.*, *supra* note 60 for a description of the exposure evidence required in the proposed Congoleum plan.

that as matter of efficiency, the bankruptcy trusts would establish a joint claims resolution facility to process claims for most of the trusts. The Eagle Picher and UNR trusts have done so but on a limited scale. The largest processing entity is the Claims Resolution Management Corporation (“CRMC”), a division of the Manville Personal Injury Settlement Trust, which processes the Manville Trust’s claims. The CRMC actively bids for newly emerging trusts’ claim processing.

The absence, to date, of such a central processing entity highlights a significant inefficiency in the operation of bankruptcy trusts. I offer two reasons that may account for the persistence of this inefficiency.

First, a joint processing facility would undoubtedly “computerize” the data submitted with claims. This would easily enable the facility to assemble the complete composite work history of each claimant by combining the exposure claims for each claimant from the claimant’s submissions to each trust. For example, claimant A’s submission to Trust JM might state, *inter alia*, that A worked at jobsite JM in June—November, 1960 and that is where he was exposed to JM’s products. Claimant A’s submission to Trust EP might state, *inter alia*, that he worked at jobsite EP from May -- October 1960 and that is where he was exposed to EP’s products. The computer could easily be programmed to spit out such conflicting exposure claims. If plaintiff lawyers submit such conflicting exposure claims with some frequency, then a centralized processing facility would be unwelcome.

A second reason why trustees of the bankruptcy trusts may not have established an industry-wide joint claim processing facility is that claims processing is a lucrative

business which presents substantial profit opportunities. On rare occasions, these profit opportunities become quite visible.¹²²

If as I suggest this may be occurring, the corroborating evidence sits in the computer files of the asbestos trusts. But plaintiff lawyers control these trusts, having effectively selected the trustees and constituting the Trust Advisory Committees which have authority to oversee trustees' actions. No matter how inculpatory this evidence may be, it remains off limits to any form of public scrutiny, even as a matter of reality, scrutiny by bankruptcy courts or by the U.S. Trustee. Only a substantial investigatory effort by this Committee in the exercise of its oversight authority over operation of the bankruptcy laws, could succeed in shaking loose this data, which reposes in the computer files of the bankruptcy trusts.

VII. Conclusion

The asbestos bankruptcy practices I have described coupled with some of the implementations of bankruptcy law in the bankruptcy courts which cede near unbridled power to plaintiff lawyers, in my judgment, constitute a unprecedented assault on the integrity of the bankruptcy process.

¹²² See, e.g., *In re Nat'l Gypsum Co.*, 243 B.R. 676 (Bankr. N.D. Tex 1999) suggesting that the managing trustee of the NGC Settlement Trust resign as a condition for the trust to be allowed to purchase stock held by that trustee in a claims processing enterprise); Mem. of the United States Trustee In Support of Objection To Debtor's Application To Employ The Kenesis Group, *In re ACandS, Inc.* No. 02-12687 (RJN) (Bankr. D. Del 2003) (concluding that the debtor had retained a claims handling firm that was owned by the debtor's law firm to do postpetition claims processing which had subcontracted the work to an affiliate of a law firm represent claimants without disclosing these relationships or seeking bankruptcy court approval).

A necessary first step in restoring the integrity of the process is to identify and expose those practices and implementations that are having the most egregious effects. The Second Circuit Court of Appeals has noted that “the conduct of bankruptcy proceedings not only should be right but must seem right.”¹²³ There is much going on here that at least does not “seem right” and raises compelling questions about the integrity of the bankruptcy process. This includes the circumstances surrounding the issuance of a rare writ of mandamus removing Judge Wolin as well as the other disquieting events that I have noted in this statement. It would appear, therefore, to be incumbent on the courts to undertake their own investigation of what is occurring by the appointment of special examiners to inquire into the process, take the testimony of some of the key players and report their findings.¹²⁴

In addition to the creation of an appropriate mechanism by the courts to provide a full and detailed account of what has transpired during the course of Judge Wolin’s administration of five asbestos bankruptcies, or failing such creation, then one to be undertaken under the auspices of the Judiciary Committee, I also urge the Committee to undertake a more pervasive study of the operation of the bankruptcy process in the context of asbestos bankruptcies.

¹²³ *In re Haupt & Co.*, 36 F.2d 164, 168 (2nd Cir. 1966).

¹²⁴ Under the bankruptcy code, a debtor in possession has an obligation to act as a fiduciary for the entire estate. One of the remedies for breach of this duty is the appointment of a trustee or examiner. Bankruptcy Code §1104(c) provides that of the bankruptcy court does not appoint a trustee, then at any time before the confirmation of a plan, on request of a party in interest or the United States Trustee, and after notice and hearing, the court shall order the appointment of an examiner to conduct such an investigation of the Debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the Debtor or by current or former management of the Debtor, if—

- (1) Such appointment is in the interest of creditors. . . . or
- (2) The Debtor’s fixed, liquidated, unsecured debts, . . . exceed \$5,000,000.

11 U.S.C. § 1104(c).

Finally, I recommend as an additional requisite step, amending §524(g) of the Bankruptcy Code to modify those perverse provisions that promote bogus claiming and repose near unbridled power in the hands of plaintiff lawyers. To that end, I urge this Committee to undertake the process of amending the Bankruptcy Code to restore both its balance and the integrity of the process.