Bankruptcy Rule 9031: Out of Date and Out of Touch—Why an Amendment is Long Overdue

Article

ALM | Law.com
June 7, 2024

By: Mark Conlan and Noel L. Hillman

Rule 9031 of the Federal Rules of Bankruptcy Procedure (the Bankruptcy Rules) prevents all bankruptcy judges, and, if broadly interpreted, any federal judge hearing bankruptcy cases and proceedings, from appointing special masters. The rule has not been amended since its adoption in 1983. It is outdated and should be repealed or amended to accord with the reality of today's complex Chapter 11 cases and related proceedings.

Why are special masters barred in bankruptcy? The text of Bankruptcy Rule 9031 says little about the prohibition. It simply states that "Rule 53 Fed.R.Civ.P. does not apply in bankruptcy cases." The Advisory Committee Note to Rule 9031, which is also a single sentence, states in its entirety that "[t]his rule precludes the appointment of masters in cases and proceedings under the Code." Thus, by adding the word "proceedings" the committee note attempts to significantly broaden the scope of the rule. Neither the rule itself nor the advisory committee note provide any justification for this far-reaching prohibition on the use of special masters in bankruptcy.

Together, the rule and the committee note seem to suggest an unwarranted wariness of bankruptcy judges. While such concerns may have given pause to the use of special masters decades ago, they are no longer valid in light of the safeguards in place today and the sophistication, professionalism, and integrity of bankruptcy courts.

Initially, the title of Bankruptcy Rule 9031 ("Masters Not Authorized") does not line up with the text of the rule that says "Rule 53…does not apply in cases under the Code." That incorrectly assumes that Fed. R. Civ. P. 53 is the only authority for appointing special masters in federal courts. Long before Rule 53 was adopted in 1938,

federal courts in the United States have appointed special masters. See e.g., Ex parte Peterson, 253 U.S. 300, 312-313 (1920):

Courts have (at least in the absence of legislation to the contrary) inherent power to provide themselves…This power includes authority to appoint persons unconnected with the court to aid judges in the performance of specific judicial duties, as they may arise in the progress of a cause. From the commencement of our government, it has been exercised by the federal courts, when sitting in equity, by appointing…special masters, auditors, examiners and commissioners.

Courts have also relied on their inherent power to appoint special masters in criminal proceedings, even though the Federal Rules of Criminal Procedure do not provide for the appointment of such neutrals. See e.g., United States v. Black, 2016 U.S. Dist. LEXIS 164571 (D. Kan. Nov. 29, 2016). However, given the express prohibition against appointing special masters in the title of Bankruptcy Rule 9031, it is understandable why judges honor the rule.

Some courts have nevertheless circumnavigated Bankruptcy Rule 9031's mandate against using masters in bankruptcy by appointing neutrals under other names. See e.g., In re Owens Corning, 305 B.R. 175 (D. Del. 2004) (the district court appointed "advisors" in asbestos cases where the bankruptcy court reference had been partially withdrawn).

When the prohibition on special masters in bankruptcy was reconsidered in 1996, the Federal Judicial Center published a report that recommended amending Rule 9031 to permit the appointment of special masters in bankruptcy. That report found that "[t]he roles, duties, and responsibilities of bankruptcy trustees and examiners are significantly different from, those of special masters and are not adequate alternatives to the appointment of special masters (and vice versa)."

While the Bankruptcy Code provides for the appointment of trustees, examiners and official committees of unsecured creditors in certain circumstances, they do not serve the same function or duplicate the role of a special master or neutral.

Despite the Federal Judicial Center's recommendation that Bankruptcy Rule 9031 be amended to authorize the use of special masters in bankruptcy, the Advisory Committee on Bankruptcy Rules voted against the proposed rule change by an 8-5 vote.

According to a recent analysis supporting amendment of Rule 9031 prepared by the Rabiej Litigation Law Center, it appears that the Advisory Committee's 1996 vote against amending Bankruptcy Rule 9031 was in large measure based on the analysis of its reporter, Professor Alan Resnick, whose primary concerns (infringement on the authority of bankruptcy judges and inefficiency) were subsequently addressed in 2003 when Fed. R. Civ. P. 53 was substantially amended. That amendment included changing the appointing court's standard of review from "clearly erroneous" to "de novo." Rule 9031 should have been amended in 2003 to compliment the changes made to Rule 53.

Any concern that repealing Rule 9031 will give bankruptcy judges carte blanche does not survive close scrutiny. Repealing the rule simply puts them on par with other federal judges. Rule 53 sets a high, exacting, standard to be invoked rarely and only in the right case. The Judicial Conference and relevant rules committees can be confident that bankruptcy judges will use Rule 53 authority with the same level of discretion and good judgment exercised routinely by judges in other complex litigation. And the time for the prudent exercise of such discretionary power is clearly at hand.

Bankruptcy Rule 9031 was again reviewed in 2009 when the Judicial Conference voted not to amend it for reasons that are now woefully outdated. Since that time, bankruptcy cases and proceedings in the United States have become much larger and more complicated. America's bankruptcy courts routinely handle complex retail, financial, health care, environmental and mass tort cases, some involving tens of thousands of claimants asserting claims arising from opioid addiction, sexual abuse or diseases related to asbestos and/or talc exposure.

In 2023, 30 Chapter 11 cases were filed in the United States with liabilities in excess of $1 billion (including We Work with liabilities in excess of $10 billion). So far this year, there are already 19 filed Chapter 11 cases with liabilities exceeding $1 billion dollars. No matter how complicated any of those cases may be, Bankruptcy Rule 9031, titled "Masters Not Authorized," arguably bars all federal judges, and certainly bankruptcy judges, from appointing a special master in any of those bankruptcy cases or related proceedings. For those judges handling such complex matters, Rule 9031 unnecessarily ties one hand behind their backs.

But the tide is turning as it should. The recently expressed views of an experienced and well-regarded jurist on this issue have sparked a renewed effort to bring Bankruptcy Rule 9031 in line with modern reality and case management practices routinely employed in other forms of complex federal litigation.

Chief Judge Michael B. Kaplan of the U.S. Bankruptcy Court for the District of New Jersey, who recently oversaw the highly contentious serial chapter 11 filings by Johnson & Johnson subsidiary LTL Management, recently wrote to the Committee on Rules of Practice and Procedure asserting that it is time for Rule 9031 to change and permit the use of special masters in bankruptcy cases and proceedings the same way they are used in other federal cases. During the time since an amendment to Rule 9031 was last considered, the complexity of Chapter 11 cases and the volume of related litigation have grown significantly. Kaplan's Jan. 10, 2024, letter to the Committee highlighted the growing number of large cases involving mass torts, financial institutions and, more recently, large cryptocurrency filings.

This trend promises to continue as disruptive technologies, how we buy and sell goods, changes in work habits, litigation finance and an increasingly global economy are picking winners and losers even when financial markets are at all-time highs.

Kaplan proposed the following simple, but meaningful, changes to Rule 9031:

Rule 9031. Masters Authorized.

Rule 53 Fed. R. Civ. P. applies in cases or proceedings under the code.

This amendment (and adopting a similar Rule 7053 for adversary proceedings and conforming changes to Rule 9014 for "contested matters") would provide bankruptcy courts with the authority to appoint special masters and greatly reduce the burden on bankruptcy courts overseeing complex Chapter 11 cases and related proceedings.

If the rule is changed, special masters could assist bankruptcy courts as they currently do in complex district court cases, efficiently moving the cases forward and handling discovery disputes, ESI protocols, and protective orders, all without burdening the court. They could also help facilitate settlement discussions and provide analysis and calculations of large claim pools.

Kaplan's letter also suggests that masters would be beneficial in addressing "complex issues such as corporate asset valuations, claims estimations, fraudulent transfer litigation and challenges to pre-filing

liability management transactions."

Simply put, there is no good reason why bankruptcy or any other judges should be prohibited from exercising their discretion to appoint masters in complex Chapter 11 cases and related bankruptcy proceedings, where doing so will lead to an efficient resolution of the matter, and every good reason why they should not be so constrained.

Importantly, Kaplan's recent push for reform echoes the long-standing official policy of the American Bar Association (ABA). According to ABA President Mary Smith's Feb. 12, 2024, letter to the Judicial Conference of the United States, the ABA stands by its 2019 Resolution 100 that there should not be a general prohibition against the use of court-appointed neutrals in bankruptcy cases.

The reasoning behind the 2019 resolution, formulated by a distinguished group of judges, bar leaders, and experienced practitioners remains as forceful today as it did then, if not more so. Resolution 100 wisely and persuasively encourages courts to make greater and more systematic use of special masters to assist in civil litigation, and concludes, as we do here:

[T]here is no justification today for a rule that assumes that bankruptcy judges can never make effective use of special masters. Bankruptcy dockets include many especially complex cases in which special masters could be of great utility. Depriving court[s] of equity of the ability to use special masters, disserves the goal of achieving a "just, speedy and inexpensive determination of every case and proceeding," which is the mandate of Bankruptcy Rule 1001, just as it is the mandate of Federal Rule 1. Amending Rule 9031 to eliminate this confusing limitation serves this end.

We could not say it any better.

AWARD METHODOLOGY