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2023

Straight & Narrow

By Hon. Cynthia A. Norton[1]

The Ethics of Virtual Representation

10 "Cs" of the COVID-19 Ethical Apocalypse

Hon. Cynthia A. Norton
U.S. Bankruptcy Court (W.D. Mo.); Kansas City

Hon. Cynthia Norton is a bankruptcy judge for the U.S. Bankruptcy Court for the Western District of Missouri in Kansas City. She is a past recipient of the Michael R. Roser Excellence in Bankruptcy Award and the Robert L. Gernon Award for Outstanding Contribution to CLE, as well as a Fellow in the American College of Bankruptcy.

I had hoped that almost two years into the COVID-19 pandemic we would have returned to normalcy. Like most judges I know, I miss seeing lawyers and being in the courtroom. Judges and lawyers had to learn almost overnight new technologies to effectively do their jobs. I am proud of how quickly the bankruptcy bench and bar adapted.

However, the pandemic is still with us, and we are still working in a virtual environment. I have been tracking the ethical ramifications of this reality since the pandemic began, and I have found that virtual representation has raised unprecedented ethical issues. So, with coronavirus on my mind, here are 10 "C" words related to the ethics of virtual representation for lawyers to consider.[2]

Competence

Most states specify that the duty of competence under Rule 1.1 requires lawyers "to keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology." Although we laughed at the viral video of the lawyer who could not turn off his cat filter during a hearing,[3] more serious competency issues have arisen during the COVID-19 pandemic. For example, a lawyer defending his client during a remote deposition was found to have waived the attorney/client privilege when he did not promptly object during questioning about a document; the fact that he was using a device that did not allow him to clearly see the document was not a defense, the court said.[4] Ouch.

Beyond which device you use, how do you preserve an objection for the record if you forget you were muted or fumble while unmuting? Virtual representation has not changed substantive law, and using your device to record a deposition does not make it admissible unless you comply with the federal rules.[5] Some commentators have suggested that the duty of competence should now also include perfecting your virtual advocacy skills, such as how to present exhibits, how to dress and speak in a way that is persuasive and credible over a tiny computer screen, and how to coach your witnesses to likewise testify persuasively and credibly.

Consent

Malpractice experts report a rise in what is known as "settle and sue cases," in which clients allege after a settlement that they never consented to settle. Rule 1.2(a) requires that lawyers abide by a client's decisions concerning the objectives of the representation. Some proposed courses of action require a client's informed consent in writing in advance,[6] but obtaining consent in a virtual environment might be more difficult, particularly if the client is in a remote location and does not have access to email or the ability to scan and send back a signature page. When negotiating or mediating a case virtually, lawyers should plan ahead and discuss with opposing counsel and their own clients how to document consent if a settlement is reached.

Calendaring

Calendaring errors are one of the biggest drivers of ethics and malpractice complaints. Missing deadlines is a potential violation of MRPC 1.3, which requires that a lawyer act with reasonable diligence and promptness. Ethics experts warn that working in isolation without a partner or staff member in the office to remind you that a response deadline is approaching may result in more lawyers missing deadlines. Think carefully about your calendaring system, and make sure you have a back-up system in place to help remind you of impending deadlines while working remotely.

Communication

In a recent survey, almost half of all lawyers reported having difficulty reading witnesses' body language,[7] but this applies equally to your clients, too. Rule 1.4 communication failures are another large driver of client complaints. When I had difficult issues to discuss with my clients, I always met them in person so I could gauge how they were reacting. There are nuances in effective communi-

1 This article is derived from seminar materials originally presented to the Kansas City Bankruptcy Bar Association in November 2020. Thanks go to my law clerks, **Erica M. Garrett** and **Jeff Merritt**, for their assistance.

2 All references to the ethics rules are to the ABA Model Rules of Professional Conduct (MRPC). Please consult the ethics rules in your jurisdiction for specific guidance.

3 Daniel Victor, "'I'm Not a Cat,' Says Lawyer Having Zoom Difficulties," *N.Y. Times* (Feb. 9, 2021), *available at* nytimes.com/2021/02/09/style/cat-lawyer-zoom.html (subscription required to view article; unless otherwise specified, all links in this article were last visited on Jan. 18, 2022).

4 *Orthorpaedic Hosp. v. DJO Global Inc.*, 2020 WL 5363307 (S.D. Cal. Sept. 8, 2020).

5 *Alcorn v. City of Chicago*, 336 F.R.D. 440 (N.D. Ill. 2020) (compliance with Fed. R. Civ. P. 28 and 30 required).

6 MRPC 1.0(e).

7 Robert Brown, "Analysis: Many Remote Lawyers Struggle to Read Body Language," Bloomberg Law (Oct. 19, 2021), *available at* news.bloomberglaw.com/bloomberg-law-analysis/analysis-many-remote-lawyers-struggle-to-read-body-language.

cation with clients — tone of voice, body language and eye contact — that are not possible in text or writing, or over the phone. How do you ensure that your client is tracking with you or answering you honestly if the difficult meeting occurs on Zoom? Practicing in the virtual environment requires you to carefully consider how to communicate accurately and promptly.

Cyberhygiene

There are two components to "cyberhygiene," or ensuring that your clients' information remains confidential as required by Rule 1.6. The first is technological, in that you have robust passwords, virus protection, firewalls and other safeguards in place to keep cybercriminals from hacking client information. There have been several high-profile news stories since the COVID-19 pandemic of law firms being hacked, as hackers are keenly aware that more attorneys are working remotely.[8] The second, often overlooked, component of cyberhygiene is ensuring that your home office environment is also safe from nosy children or spouses. In a case last year, an estranged spouse used his wife's thumbprint while she was sleeping to open her office device and obtain access to her client's files to use it against her in a divorce.[9] Review the safeguards — both technological and physical — that you have in place to secure client files and other information while working remotely or in your at-home office.

Coaching

We know Rule 3.4 — fairness to opposing parties and counsel — as the rule that requires you not unlawfully obstruct another party's access to evidence. Rule 3.4 does not use the word "coaching," as in coaching your witness, but that is one of the evils the rule is clearly intended to prevent.

When a lawyer attempts to coach a witness in the courtroom, opposing counsel or the judge calls it out because they see it. The issue in remote hearings and depositions, though, is what if you can't see it? The fear is that opposing counsel might be handing the client notes or texting answers, or the witness might be consulting documents that are not approved exhibits.

Anecdotally, many lawyers I have talked to report that they have noticed witness behaviors that strongly suggested that the witness was being coached, such as the witness turning his head and obviously reading from something. These lawyers told me they were not sure what to do. In court proceedings, most courts have Zoom or other virtual-hearing protocols that prohibit other people from being in the room or communicating with the witness, and that prohibit the witness from consulting anything other than marked and identified exhibits. However, experts are suggesting that asking the judge to enforce the protocols might not be enough to protect against coaching. A careful lawyer should consider asking the judge to include in the pretrial order requirements for the room in which the witness will be testifying (*e.g.*, that the lighting is adequate to see the surroundings and that the camera angle is wide enough to see the hands and torso of the witness, and that a test appearance occur with the courtroom deputy or other court personnel in advance to ensure compliance). You may also want to ask witnesses on cross-examination to confirm that they have not communicated with anyone or consulted any other documents. The bottom line is that just as you should not coach your witness (whether appearing live or virtually), you should also verify that your opposing counsel is not coaching, either.

Coronavirus Safety

What I am labeling "coronavirus safety" invokes another component of Rule 3.4: the requirement that you obey court orders and rules. It involves how you protect yourself and clients, and avoid sanctions when you are considering whether to request a live or virtual hearing in the pandemic era. For example, what if your client insists on having a live trial — not out of health concerns, but for a strategic advantage or for improper delay?[10] What if your health situation is such that you are not comfortable with a live trial, or you are unable or unwilling to comply with a mask mandate imposed by the trial judge?

In a case last year, a lawyer was held in contempt when, due to health concerns and at the requirement of his employer, he appeared virtually at a hearing instead of live, in violation of the trial court's order.[11] In another instance, the judge dismissed a lawyer's case when he wore a face shield instead of a required mask.[12] The court was unmoved by the lawyer's plea that he could not breathe in a mask.

The Bar of the City of New York has issued an opinion addressing when a lawyer's health concerns about the coronavirus might create a conflict of interest requiring a lawyer to withdraw,[13] but this may also cut the other way. Suppose you strongly believe that a live trial is in your client's best interests, but out of health concerns your client refuses. What if your client loses, say, a virtual trial and accuses you of malpractice for not insisting on a live trial, or worse, a technical glitch occurs that the client believes is your fault, and you have not explained in advance the risk that the remote witness might have trouble connecting and might be unable to provide the crucial testimony you need to win? What I am calling "cyberhygiene" actually involves many "Cs" — competence, consent, communication, conflict of interest and candor to the tribunal — and in a high-stakes case, it should compel you to tread carefully.

De"c"orum

I am stretching for this "C," but I am doing so because this "C" is so important. Rule 3.5(d) requires that a law-

8 Ben Kochman, "COVID Inflamed Damaging Year for Data Breach Victims," *Law360* (March 11, 2021), *available at* law360.com/articles/1363611/covid-inflamed-damaging-year-for-data-breach-victims (subscription required to view article).

9 Brian Flood, "Attorney Who Says Ex-Spouse Accessed Her Work Emails Can Sue Him," Bloomberg Law (Dec. 8, 2020), *available at* news.bloomberglaw.com/business-and-practice/attorney-who-says-ex-spouse-accessed-her-work-emails-can-sue-him.

10 See Fed. R. Bankr. P. 9011(b) (lawyers' signatures on filed papers constitute certification that they are not presenting paper for any improper purpose, such as to cause unnecessary delay or expense).

11 Lance Benzel, "Colorado Springs Attorney Found in Contempt for Refusing to Show Up for Trial Amid COVID-19 Threat," *Colorado Springs Gazette* (Oct. 27, 2020), *available at* gazette.com/news/colorado-springs-attorney-found-in-contempt-for-refusing-to-show-up-for-trial-amid-covid/article_608df9c6-1897-11eb-bcc0-a3ffa42518cf.html.

12 Emma Whitford, "NY Judge Dismisses Case Because Atty Wouldn't Wear Mask," *Law360* (March 26, 2021), *available at* law360.com/pulse/articles/1369206/ny-judge-dismisses-case-because-atty-wouldn-t-wear-mask.

13 Formal Opinion 2020-5: A Lawyer's Ethical Obligations When Required to Return to Court in Person During a Public Health Crisis.

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yer not engage in conduct intended to disrupt a tribunal. Violations of Rule 3.5(d) often go hand-in-hand with violations of Rule 8.2, prohibiting a lawyer from making statements that he/she knows to be false or with reckless disregard as to the statement's truth or falsity.

For this "C," I am thinking of something more serious than not being able to turn off a cat filter: the "hot mic" moment. In a live trial, you sit next to clients and have (hopefully) advised them not to make an outburst when the judge rules. Imagine, though, that your client is appearing remotely, and you have not reminded the client not to react and to remain muted, then the client blurts out a disparaging remark about the judge or ruling? Worse, what if you are not muted and you do so, or you criticize the judge or opposing counsel in a side chat with your client, not realizing all parties have access to the side chat?

In a recent case in Missouri, a lawyer shouted a profane curse after he lost a discovery dispute during a hearing conducted remotely. The lawyer thought he had disconnected, but unfortunately realized that he had failed to do so after the judge replied, "What did you say?"[14] It is easy to forget that you are muted when using a device, but it is just as easy to forget that you are unmuted. Counsel your remote client about how to behave, and save the profane remarks about judges and their rulings until you are sure no one else is listening. Better yet, do not utter profane remarks at all.

Conduct Unbecoming

Conduct that is prejudicial to the administration of justice violates Rule 8.4(d), which prohibits general misconduct. There are several potential traps for the unwary that might fall under the rubric of misconduct. The first is inappropriate behavior during a virtual meeting, deposition or trial. In a story that made headlines, a lawyer was suspended after he was caught pleasuring himself while, unbeknownst to him, his video was still on.[15]

Second is inappropriate dress: Remote hearings are official court proceedings and require appropriate professional dress. Judges have reported lawyers lying on their beds, sitting on the toilet, dressed only from the waist up and so on. All are violations of Rule 8.4(d).

Third is what some commentators have called "Background Bingo," or appearing with inappropriate images or artwork or other activity in the background. Your remote appearance should be in a neutral and professional setting and not contain items or images that may insult opposing parties or influence the judge.

Finally, and potentially most seriously, is the fact that recording hearings is not only a violation of court rules and cause for sanctions or suspensions of filing privileges, it may also constitute a federal crime. As we know, our electronic devices make it easy for us to record. I trust no lawyer would knowingly record a hearing in violation of the court's rules, but did you remember to tell clients and witnesses not to record, and that the prohibition against "recording" is extremely broad?

In the words of one court, this rule includes not "capturing, reproducing, rebroadcasting, disseminating, or duplicating any court video, image or audio content, whether by screenshot, screen capture or any other medium or capability."[16] Never forget that some clients, when faced with the consequences of their own bad behavior, will blame their lawyer, either claiming the lawyer never told them not to record or, worse, that the lawyer told them to do so!

Civility

My final "C" is for civility. Civility and professionalism are essential to the operation of our legal system. Conducting oneself with civility requires treating everyone — clients, opposing parties, counsel and the court — with respect. It can be easy to forget to behave civilly during these trying and terrible times, but if we all comport ourselves by remembering our obligation to be civil and professional, it will help us get through this together.

Final Thoughts

The COVID-19 pandemic has posed many changes and challenges — societal, economic and technological, just to name a few. Even after the pandemic is over, courts will likely retain many aspects of virtual proceedings, given the savings, convenience and access to justice such hearings allow. Sweeping technological changes always raise new ethical challenges for lawyers. As the technologies supporting virtual practice evolve, new ethics issues are also bound to arise. I hope that this article inspires you to think about those ethical challenges so that you may rise to meet them.[17] abi

14 Kathryn Rubino, "Lawyer Heading to Jail After Telling Judge 'F*ck You,'" *Above the Law* (July 19, 2021), *available at* abovethelaw.com/2021/07/lawyer-heading-to-jail-after-telling-judge-fck-you (lawyer initially held in criminal contempt and ordered to spend seven days in jail; order later vacated).

15 Emma Cueto, "Dogs, Babies, Tech Flops: Attys Share Zoom Fails and Tips," *Law360* (Oct. 28, 2020), *available at* law360.com/bankruptcy/articles/1323460/dogs-babies-tech-flops-attys-share-zoom-fails-and-tips (subscription required to view article).

16 "Standing Order 21-207 — Prohibition on Recording or Retransmission of Video or Telephonic Conferences and Hearings," U.S. Bankruptcy Court, W.D. Pa. (March 22, 2021), *available at* www.pawb.uscourts.gov/news/standing-order-21-207-prohibition-recording-or-retransmission-video-or-telephonic-conferences.

17 For more guidance, *see* ABA Formal Opinions 495 (unauthorized practice of law while working remotely) and 498 (discussing multiple ethics rules related to working remotely).

Feature

By Thomas J. Salerno and Clarissa C. Brady

In Defense of Third-Party Releases in Chapter 11 Cases: Part I

Let's Define the Battlefield!

Editor's Note: *This is Part I of a three-part series.*

"Nicht das Kind mit dem Bade ausschütten!"
— Thomas Murner, *Narrenbeschwörung*[1]

Thomas J. Salerno
Stinson, LLP; Phoenix

Clarissa C. Brady
Stinson, LLP; Phoenix

Thomas Salerno is a partner with Stinson, LLP in Phoenix and a past ABI Vice President-Development. Clarissa Brady is an associate in the same office.

The negotiation and confirmation of financial restructuring deals, even in cases of modest size, are very much like sausage-making. With apologies to our vegetarian colleagues, most people can agree they want a good bratwurst, but watching one being made is neither pretty nor recommended. Chapter 11 is judicially supervised negotiation at its core. Financial restructurings involve the creation of sometimes tenuous alliances, then trying to keep them together while recalcitrant constituencies snipe for tactical purposes as the case slogs its way through the arduous process that is chapter 11.

Not surprisingly, the odds are not with the troubled business trying to navigate the rocky shores of chapter 11.[2] The path from the filing (often under emergency circumstances) to the closing dinner and exchange of the Lucite deal cubes belies the sometimes tense and contentious events leading up to the confirmation of a plan that memorializes the numerous deals made to get there. That is, at least in the authors' humble opinions, what also makes chapter 11 so exciting. In the immortal words of John "Hannibal" Smith, "I love it when a plan comes together!"[3]

Which brings us to the topic of this article. Reminiscent of a scene from a Mary Shelley novel, villagers wielding torches and pitchforks lay siege to the castle of a miscreant and call for the death of "the monster." The metaphorical death sought in this case is the definitive end (once and for all) of the use of third-party releases in restructuring cases. The "monster" in this analogy is played by the Sackler family, controlling interest-holders in *Purdue Pharma*, who undeniably made billions in profits from the opioid scourge.[4] Purdue sought chapter 11 protection based primarily on more than 3,000 personal-injury/product-liability lawsuits filed against it and its various subsidiaries and affiliates. To avoid this "veritable tsunami of litigation,"[5] as part of its proposed chapter 11 reorganization plan, Purdue sought to trade a release of civil liability against the Sackler family for a payment by the Sacklers (and their various entities) of about $4.3 billion into a trust fund to pay victims of the opioid scourge that has been ravaging the U.S.[6] since the early 1990s.

The bankruptcy court confirmed the plan with its proposed release over the objection of nine attorneys general[7] (the "objecting states") and about 2,700 individual plaintiffs in personal-injury lawsuits against *Purdue Pharma*, which confirmation order was reversed by Hon. Colleen McMahon of the Southern District of New York on Dec. 16, 2021.[8] The district court granted the motion seeking leave to appeal to the Second Circuit (over the objecting states' objection).[9] Meanwhile, Hon. **Robert D. Drain** of the U.S. Bankruptcy Court for the Southern District of New York first extended the temporary litigation stay for the Sacklers until Feb. 1, 2022, then through Feb. 17, 2022,[10] and

1 "Don't throw the baby out with the bathwater!" *Appeal to Fools* (1512).

2 The "success rate," always a somewhat murky concept when applied to a process as diverse as chapter 11 given the myriad potential outcomes being sought, is somewhere between 10-33 percent, depending on whose statistical analysis you use. *Cf.* "Chapter 11 Bankruptcy," *Fin. Mgmt.* (Sept. 7, 2020), *available at* efinancemanagement.com/financial-leverage/chapter-11-bankruptcy (estimating an "abysmally low" success rate of "around 10% or so"; unless otherwise specified, all links in this article were last visited on Jan. 24, 2022), *with* Elizabeth Warren & Jay L. Westbrook, "The Success of Chapter 11: A Challenge to the Critics," 107 *Mich. L. Rev.* 603 (2009) (using statistical analysis gauging success in chapter 11 cases of between 17-33 percent). Part of the difficulty is caused by one's definition of "success" in chapter 11. A sale of all assets within the first 30 days of the case, even with very little return to general unsecured creditors, with a plan confirmed distributing proceeds might be a "successful" chapter 11 in one sense, even if not economically.

3 George Peppard as J. "Hannibal" Smith in "The A Team" (1983-87). Of course, that same show gave us the line "I pity the fool!," which might be applied to those about to embark on the financial-restructuring process. But we digress.

4 *In re Purdue Pharma LP* and subsidiaries and affiliates, Case No. 7:19-bk-23649 (Bankr. S.D.N.Y.) ("*Purdue Pharma*"), and *In re Purdue Pharma LP*, 2021 WL 5979108 (S.D.N.Y. Dec. 16, 2021) ("SDNY Opinion").

5 SDNY Opinion at 2.

6 The opioid scourge has been called a "uniquely American problem" because the abundance of private health insurance in the U.S. favors prescribing drugs for pain management over alternative, more expensive therapies. *See* Edward A. Shipton, Elspeth E. Shipton & Ashleigh J. Shipton, "A Review of the Opioid Epidemic: What Do We Do About It?," *Pain and Therapy*, at 7 (1): 23-36 (June 2018), *available at* link.springer.com/article/10.1007/s40122-018-0096-7. Pills are less expensive and a quick fix for what ails you — until the "cure" creates other problems, of course.

7 Attorneys general for California, Connecticut, District of Columbia, Delaware, Maryland, New Hampshire, Oregon, Rhode Island and Washington objected to plan confirmation and ultimately appealed the confirmation order. The U.S. Trustee also objected and joined in the appeal.

8 *See* SDNY Opinion; *see also* Paul R. Hage, "'The Great Unsettled Question': Nonconsensual Third-Party Releases Deemed Impermissible in *Purdue*," XLI *ABI Journal* 2, 12-13, 43-45, February 2022, *available at* abi.org/abi-journal (thorough overview of SDNY Opinion).

9 *See* Order Conditionally Granting Debtors' and Allied Parties' Motion for a Certificate of Appealability dated Jan. 7, 2022 (Docket 117) ("Appeal Certification Order"). The "condition" is that the appealing parties seek expedited consideration of the appeal (which seems superfluous, as an expeditious resolution of this issue seems to certainly be in the debtors' best interest in these cases). California, Maryland and the District of Columbia filed oppositions to the request for leave to file the interlocutory appeal. *See* Vince Sullivan, "States Oppose Purdue's 2nd Circ. Appeal Try in Ch. 11 Case," *Law360* (Jan. 7, 2022).

10 *See* Maria Chutchian, "Purdue Bankruptcy Judge Extends Temporary Litigation Shield for Sacklers," Reuters (Dec. 28, 2021); "Purdue Pharma Judge Extends Sacklers' U.S. Litigation Shield to Feb. 17," Reuters (Feb. 1, 2022). It is likely that this shield will be extended again should serious progress be made on the mediation and settlement front.

ordered the case to mediation. Upon Purdue's request, the Second Circuit granted leave to file the appeal and also put the appeal on a very fast track, with oral arguments scheduled for April 25, 2022.[11] Barring settlement (always a possibility),[12] and regardless of the fast track the Second Circuit put this appeal on, it is a distinct possibility that whoever loses that appeal will seek review by the U.S. Supreme Court.

The SDNY Opinion, with its unequivocal rationale that there is no subject-matter jurisdictional authority under any circumstances for nondebtor releases in bankruptcy cases, has been characterized as a "seismic shift" in the development of the law.[13] To put this into context, the plan (with the releases for the Sackler families) had the support of approximately 120,000 opioid-related claim creditors (representing approximately 95 percent of that group), as well as 97 percent of nearly 4,800 local and state governments (including tribal authorities) in addition to 40 state attorneys general.[14] The plan, however controversial, was undeniably a highly negotiated resolution of very thorny mass tort issues, which garnered overwhelming support among creditor constituencies. In most other chapter 11 cases, the accepting votes would have been a crowning success story.

But *Purdue Pharma* is not a typical chapter 11 case. The opioid scourge has rightfully been declared a U.S. "public health emergency."[15] In the U.S., it is estimated that between 1990 and 2020, there were more than 841,000 deaths by drug overdose, with prescription and illicit opioids accounting for more than 500,000 of those through 2019.[16] In just the 12-month period ending April 2021, there was an average of 275 drug overdose deaths per day.[17] Beyond the tragic deaths, there are the ripple effects on society, resulting from addiction such as torn families, increased crime, and strains on social and medical services that follow in the wake of opioid addiction.

The "pushers" behind the opioid crisis are not unkempt characters dealing heroin in dimly lit back alleys (far from it!). The current opioid scourge in the U.S. was facilitated in high-rise boardrooms by professionals in designer clothes with dazzling PowerPoint presentations on how to "turbocharge" the sales of brand-name opioids[18] with a distribution network of highly paid consultants,[19] pharmaceutical company sales representatives and doctor's offices throughout the nation. Some of the most prevalent and addictive of the opioids were (and are) medications prescribed by doctors for pain management. Simply put, doctors had a "pill for what ails you." Purdue Pharma's actions were not "allegedly" improper; there were numerous criminal and civil settlements related to its conduct in continuing to aggressively market these drugs even in the face of internal evidence that highlighted the powerfully addictive nature of these pharmaceuticals.[20]

Which brings us back to the *Purdue Pharma* plan and proposed Sackler family release. With the frenzy surrounding the ultimate legality of third-party releases in the form of the Sackler family, they have become the unlikely poster children for an important and (used appropriately) essential tool in the restructuring tool box. The Sacklers are undeniably unsympathetic characters, and evidence shows that from 2008-17 (when it was apparent that there would be liability from damages resulting from the manufacture and sale of its opioid products), Purdue Pharma managed to "upstream" north of $10.4 billion of wealth (for the benefit of other Sackler-controlled entities, including offshore entities), much of it from the enormous profits from Purdue Pharma and its premier product, OxyContin.[21]

This differentiates *Purdue Pharma* from other product-liability-type cases involving companies (*e.g.*, *Johns-Manville*, *A.H Robins*, *Dow Corning* and *Johnson & Johnson*) that put out products that turned out to be very harmful, but the extent of the harm might not have been known at the time the product was put into the marketplace. Indeed, *Purdue Pharma* is in its own hybrid category. It is conceptually both a product-liability case and an abuse case (like the Catholic diocese, *USA Gymnastics* and *Boy Scouts of America* cases) rolled into one, where you have bad folks intentionally pushing a bad product to make money. The beneficiaries of the releases are not only insurance companies but also individuals who profited handsomely from the misdeeds — not a good category to be in, without a doubt. That notwithstanding, there is a real risk that the proverbial baby (in the form of useful third-party releases) is tossed aside with the bathwater in the battle for the unequivocal rejection of third-party releases in chapter 11 cases.

While in no way coming to the defense of the Sackler family for what they perpetrated upon the nation (all while reaping enormous profits from the resulting carnage), we undertake a spirited defense of the legality and propriety of the use of third-party releases in chapter 11 restructurings. Finally, the authors propose some straightforward legislative fixes to this issue based on amendments to existing Bankruptcy and Judicial Code provisions. Although the consensus is that the *Purdue Pharma* case presents egregious facts, including the fact that the Sacklers are responsible for creating the opioid epidemic, the "bad facts" do not justify the creation of bad law. Let the games begin!

Defining the Battlefield

"Precision of communication is important, more important than ever, in our area of hair trigger bal-

11 *See* "Purdue's Appeal on Ch. 11 Releases Fast-Tracked by 2nd Circ.," *Law360* (Jan. 28, 2022). Indeed, this has been put on the "rocket docket," with opening briefs due Feb. 11, 2022, and responsive briefs due March 11, 2022.

12 Settlement discussions are, not surprisingly, ongoing. *See* Tom Hals & Mike Spector, "Sacklers Near Deal to Increase Opioid Settlement in Purdue Bankruptcy," Reuters (Jan. 31, 2022), *available at* news.yahoo.com/sacklers-near-deal-increase-opioid-231434637.html ("Sackler family members and states objecting to terms of Purdue's bankruptcy reorganization are 'close to an agreement in principle' to contribute additional cash beyond the $4.325 billion they had pledged to settle opioid litigation, according to a mediator's interim report filed on Monday.").

13 *See* Vince Sullivan, "Seismic Purdue Ruling May Finally Get High Court's Attention," *Law360* (Dec. 17, 2021).

14 *See* Paul Scott, "Purdue Pharma Settlement Plan Approved by 95% of Creditors, but CT Still Opposed," Stamford Advocate (July 27, 2021), *available at* stamfordadvocate.com/business/article/Purdue-Pharma-settlement-plan-approved-by-95-of-16343595.php. In addition to the foregoing, creditor support from non-opioid-related claimants in other classes ranged from 88-100 percent depending on the class.

15 *See* "2016 National Survey on Drug Use and Health," Substance Abuse and Mental Health Servs. Admin. Ctr. for Behavioral Health Statistics and Quality (Sept. 7, 2017), *available at* samhsa.gov/data/sites/default/files/NSDUH-DetTabs-2016/NSDUH-DetTabs-2016.pdf.

16 *See* "Understanding the Epidemic," Ctrs. for Disease Control and Prevention (March 19, 2020), *available at* cdc.gov/opioids/basics/epidemic.html.

17 Refer to "Vital Statistics Rapid Release Provisional Drug Overdose Death Counts," CDC, *available at* cdc.gov/nchs/nvss/vsrr/drug-overdose-data.htm (refer to the "Data Table for Figure 1a, 12 Month-Ending Provisional Counts of Drug Overdose Deaths").

18 Familiar names such as OxyContin, Percocet, Vicodin and Norco, all drugs related to opioids.

19 Such as, for example, consulting powerhouse McKinsey & Co. *See* Michael Forsythe & Walt Bogdanich, "McKinsey Settles for Nearly $600 Million over Role in Opioid Crisis," *New York Times* (Feb. 3, 2021) (McKinsey settled with attorneys general in 47 states for its role in "turbocharging" opioid sales in those states).

20 *See* SDNY Opinion at p. 2 regarding prebankruptcy criminal plea agreements on various federal criminal charges.

21 *See* SDNY Opinion at 4; *see also* "Moral Bankruptcy Doesn't Count in Sackler Family Protection Deal," *St. Louis Post-Dispatch* (Dec. 22, 2021).

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ances, when a false or misunderstood word may create as much disaster as a sudden thoughtless act."
— James Thurber, *Lanterns and Lances* (1961)

To avoid confusing different concepts because of imprecise language, it is important to define terms and concepts, as they are often conflated in the heat of the debate. There should be at least four things that all parties in a chapter 11 should be able to agree on.

First, a "*discharge*" in the sense of 11 U.S.C. §§ 524 and 1141(d) only applies to a debtor in bankruptcy. The Bankruptcy Code is clear in this respect.

Second, the concept of *nondebtor releases and exculpations*, backed by plan injunctions, for actions related to the bankruptcy proceeding are acceptable in most courts (let's call these "post-bankruptcy conduct releases"). These usually cover officers, directors, estate counsels, committee members and other professionals in the case, and always exclude from the scope of such a release fraud and other bad acts.[22] The rationale for allowance of post-bankruptcy conduct releases is straightforward: Barring fraud by the participants in the proceeding, any material actions taken in relation to the proceeding itself (such as negotiations, asset sales, and all the other myriad activities that make up a bankruptcy proceeding) are done after notice and court approval. Hence, to allow parties to sue outside of the bankruptcy process, such as the directors of a now-reorganized debtor, for negotiating, proposing and obtaining confirmation of a plan would subject parties to all sorts of collateral attacks on actions the bankruptcy court already approved (again, excepting fraud by the participants). If a recalcitrant party has an issue with a course of action in a bankruptcy proceeding, they must avail themselves of the bankruptcy process (objections, appeals from orders and the like). It is a necessary "speak now or forever hold your peace" rationale. To permit otherwise would create chaos in the lack of finality.

Third, in *asbestos-related mass tort liability circumstances*, injunctions protecting nondebtors (usually insurance companies, but also applies to others) are permitted, assuming the legal requirements of 11 U.S.C. § 524(g)(2)(B) are met. Congress added 11 U.S.C. § 524(g) to the Bankruptcy Code as part of the Bankruptcy Amendments Act of 1994 (S. 540) to provide explicit statutory authority for a bankruptcy court to order the channeling of asbestos-related claims against a debtor's insurers (or, indeed, any other third party liable with a debtor), and to provide an injunction protecting those third parties from claims if the mechanism was part of a confirmed chapter 11 plan. This enabled debtors facing immense liability due to asbestos claims to have a means to obtain contributions from such third parties (who would in turn be protected by an injunction) and thereby deal with both their past and future liabilities to asbestos claimants. In effect, Congress codified the process and ultimate ruling in the *Johns-Manville* case filed in 1982. In that case, Johns-Manville confirmed its plan in 1986, which created a trust funded in part by more than $850 million from numerous insurance companies (all of whom were given a release backed up by an injunction) to deal with billions in asbestos-related personal-injury claims. Claims were "channeled" to the trust for allowance and ultimate payment. That plan release and injunction was ultimately upheld by the Second Circuit.[23]

Finally, if releases are given in a plan to which all creditors vote to accept, that release (presumably backed up by an injunction for enforcement) would be permissible, much like a creditor can agree to modification of its rights as part of plan treatment. We will call this the "Fully Consensual Release." Similarly, a claimant with adequate notice of a proposed plan will be precluded from objecting to the approval of a plan containing the release if the objection is not timely raised.[24] In smaller cases, that is frequently how such objections are dealt with.

There are both Supreme Court and circuit court decisions that hold that failure to object to a plan with release provisions, providing that there was adequate and proper notice of the provisions effectuating the release, may not be collaterally attacked on appeal by a creditor who did not object.[25] Of course, the authors recognize that legal purists would take issue with the Fully Consensual Release insofar as there are other, nontraditional creditors (such as the EPA, SEC and the U.S. Trustee) that would have standing to object on legal grounds under 11 U.S.C. § 1109. The basic premise of any such objection would be that if the ability of a bankruptcy court to approve any third-party release (other than the *Johns-Manville* provision releases for asbestos-related claims under § 524(g)) is one of subject-matter jurisdiction, parties may not confer upon a court subject-matter jurisdiction that it does not have. Courts have an independent obligation to determine whether subject-matter jurisdiction exists, even in the absence of a challenge from any party.[26]

Conclusion

The contentious releases (such as those being advocated for in *Purdue Pharma* and the subject of scores of chapter 11 cases over the last nearly 40 years) are the nonconsensual releases for prebankruptcy conduct benefiting third parties. That is where the rubber truly meets the road in this debate, and that is the subject of Part II, coming in a future issue of the *ABI Journal*. abi

22 *See, e.g., Blixseth v. Credit Suisse*, 961 F.3d 1074 (9th Cir. 2020). *But see* Memorandum Decision, *Patterson v. Mahwah Bergen Retail Grp. Inc.*, Case No. 3:21cv167 (DJN), (E.D. Va. Jan. 13, 2022) (finding even post-bankruptcy conduct releases impermissible).

23 *See MacArthur Co. v. Johns-Manville Corp.*, 837 F2d 89 (2d Cir. 1988). Hence, § 524(g) (which applies only to asbestos-related claims) has often been called the "*Johns-Manville* provision." This was a very innovative solution to a very difficult problem and will be discussed in more detail in Part II of this article.

24 Notwithstanding case law prohibiting these types of releases, pragmatic bankruptcy judges such as Hon. James Marlar of the U.S. Bankruptcy Court for the District of Arizona (ret.) had their own methods of dealing with one or two recalcitrant creditors who were objecting to releases that otherwise had widespread support. He would rule that the releases would "carve out" the objecting creditor(s) only, then confirm the plan. Judge Marlar recognized that the objections were often interposed for tactical reasons and not because the objector really intended to spend the resources to pursue the claims. By so ruling, the legal standing of the objector was removed (as they would not be injured economically). Of course, that would not have been a solution in *Purdue Pharma* (and other more complex cases) given the numerous state and other agencies objecting (the carving out of which claims would present an economic hurdle and willingness, presumably, of the beneficiary of the release to do the deal).

25 *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 145-46 (2009) (notwithstanding issue of jurisdiction to issue third-party releases, failure to object if given notice precludes appeal under *res judicata* principles); *In re Le Centre on Fourth LLC*, 17 F.4th 1326 (11th Cir. 2021). For more on *In re Le Centre on Fourth LLC*, *see* Robert M. Charles, Jr., "Eleventh Circuit Validates Plan Release of Claims Against Insurers," XLI *ABI Journal* 2, 34-35, 46, February 2022, *available at* abi.org/abi-journal.

26 *Ruhrgas AG v. Marathon Oil Co.*, 526 U.S. 574, 583 (1999); *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 514 (2006).

Feature

By Thomas J. Salerno and Clarissa C. Brady

In Defense of Third-Party Releases in Chapter 11 Cases: Part II

Show Me the Money, and What's Wrong with the "God Clause"?

Thomas J. Salerno
Stinson, LLP; Phoenix

Clarissa C. Brady
Stinson, LLP; Phoenix

Thomas Salerno is a partner with Stinson, LLP in Phoenix and a past ABI Vice President-Development. Clarissa Brady is an associate in the same office.

Editor's Note: *The final installment of this three-part series will be published in a later issue.*

"Desperate times offered a certain flexibility in the rules of absolution."
— Dan Brown, *Origin* (2017)

In Part I, the authors discussed the *Purdue Pharma* case as it relates to the nonconsensual[1] releases of the Sackler family for payment of approximately $4.3 billion in contributions to be earmarked for payment of opioid addiction and its aftermath.[2] The order confirming the Purdue plan was reversed by the U.S. District Court for the Southern District of New York. The SDNY Opinion, with its unequivocal rationale that there is no subject-matter jurisdictional authority under any circumstances for nondebtor releases in bankruptcy cases, has been characterized as a "seismic shift" in the development of the law.[3] Despite settlement,[4] the pending "rocket docket" appeal to the Second Circuit[5] will ensure a decision sometime this summer, with a possible appeal to the U.S. Supreme Court following in its wake.

Even with the settlement that will involve an uncontested Second Circuit appeal, one is left to wonder what is to be done with the SDNY Opinion, which unequivocally holds there is no subject-matter jurisdiction to grant third-party releases. Will the Second Circuit reverse?[6] Even this "grand bargain" is not without its critics.[7]

This article explores the specifics of the often-maligned (but frequently attempted, with varying degrees of success) and the most controversial of the third-party releases: where a plan attempts (as it did in *Purdue* and scores of other plans) to give a release, backed up by an injunction, for prebankruptcy acts by a nondebtor third party for not only presently existing claims, but also future claims to the extent they are directly tied to the prebankruptcy conduct.[8] This will be called the "prebankruptcy conduct release."

There are at least three things that we hope can be agreed on. First, there can never be, nor should there ever be, any attempt to release anyone (the debtor or third party) from potential criminal liability.[9] Second, there should never be releases for future acts. Finally, there must be adequate and clear notice of any proposed prebankruptcy conduct releases to those affected by such releases.

The concept of prebankruptcy conduct releases was the brainchild of innovative professionals in an effort to create and preserve going-concern values in real time in a mass tort context. Mass tort liability cases create their own challenges — from identifying and providing notice to potential victims/claimants, to trying to ensure that some process whereby assets (such as insurance policies and other third-party funding sources) are preserved for ratable distribution to what is often a huge and

1 Or at least fully nonconsensual, as there was widespread creditor and state regulatory support for the *Purdue* plan and releases. *See* Thomas J. Salerno & Clarissa C. Brady, "In Defense of Third-Party Releases in Chapter 11 Cases: Part I: Let's Define the Battlefield!," XLI *ABI Journal* 3, 32-33, 47, March 2022, *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on Feb. 23, 2022).

2 *Id.* ("The bankruptcy court confirmed the plan with its proposed release over the objection of nine attorneys general (the 'objecting states') and about 2,700 individual plaintiffs in personal-injury lawsuits against *Purdue Pharma*, which confirmation order was reversed by Hon. Colleen McMahon of the Southern District of New York on Dec. 16, 2021."). This is referred to herein as the "SDNY Opinion." The reversal is on appeal to the Second Circuit Court of Appeals.

3 *See* Vince Sullivan, "Seismic Purdue Ruling May Finally Get High Court's Attention," *Law360* (Dec. 17, 2021).

4 On March 10, 2022, the bankruptcy court approved a mediator-brokered settlement, which resulted in at least another $1 billion being contributed by the Sacklers, with the possibility of another half billion from future sales of Sackler-related assets (bringing the total to $6 billion). Vincent Sullivan, "Purdue Reaches Final Terms on New $5.5 Billion Ch. 11 Sackler Deal," *Law360* (March 10, 2022). Vince Sullivan, "Purdue Reaches Final Terms on New $5.5 Billion Ch. 11 Settlement," *Law360* (March 3, 2022). The non-monetary terms of the settlement are also noteworthy. They include public expressions of "regret" by the Sacklers, renaming Purdue Pharma as Knoa Pharma and switching to manufacture of medications to treat addictions by 2024, the disassociation and removal of the Sackler family name from buildings, programs facilities and scholarships (as long as any announcement does not "disparage" the Sacklers), and the lack of immunity of the Sacklers from future criminal prosecution. *See* Jan Hoffman, "Sacklers and Purdue Pharma Reach New Deal with States Over Opioids," *New York Times* (March 3, 2022). This settlement is the equivalent of burning the Purdue Pharma house (with the Sackler name inside it) to the ground, then salting the earth on which it stood so nothing can grow there in the future. The bankruptcy court has extended the injunction protecting the Sacklers from lawsuits to March 23 to allow this new deal to get brought before the bankruptcy court.

5 The Second Circuit not only granted leave to file the appeal, but set briefing deadlines that will occur by March, with oral argument set for mid-April 2022. *See* Part I, *supra* n.1.

6 The objecting states have agreed not to file their opposition briefs in the pending Second Circuit appeal, leaving essentially only the Purde briefs before the Second Circuit. Presumably, it is hoped that the Second Circuit will consider this one of the "narrow circumstances" in which third-party releases are permissible, consistent with its prior precedent. *See* n.14.

7 *See, e.g.*, Sullivan, *supra* n.4 (Florida, which voted to accept the initial plan, has concerns that earmarking of increased Sackler contribution should go to all states pursuant to existing sharing agreements, not just to settling objectors as contemplated); Melody Schreiber, "OxyContin Victims Fight for Their Share in Purdue Bankruptcy Case," *The Guardian* (Feb. 27, 2022) (with victims' advocates complaining that portion of deal that is attributable to actual victims equates to about $5,000 per victim, with rest allocated to states for rehabilitative and other purposes).

8 Prebankruptcy conduct often involves claims that may manifest post-bankruptcy based on conduct that occurred prebankruptcy. Environmental-contamination and product-liability mass tort claims may not fully manifest at the time of a bankruptcy filing, as some are not even aware they have been injured because physical symptoms do not appear until a later date after the filing or there is still an open statute of limitations for filing claims.

9 Even the landmark pending Sackler settlement did not try to cross that bridge. *See* n.4, *supra.*

disparate class of creditors, all of whom are deserving of timely compensation for their injuries.

The first major use of this concept was *Johns-Manville* in 1986. Since then, it has been used in scores of large mass tort liability cases, from product liability (as in *Dow Corning* in 1995, *A.H. Robins* in 1988 and *Johnson & Johnson (J&J)* in 2021), to personal injury from abuse cases (essentially every Catholic diocese case filed and *USA Gymnastics*), and including the pending *Boy Scouts of America* case (for which *Purdue*, albeit in a different jurisdiction, will have a potentially devastating impact).[10]

The case law on this issue gets messy. As the SDNY Opinion recognized, "This issue has hovered over bankruptcy law for 35 years — ever since Congress added Section 524(g) and (h) to the Bankruptcy Code. It must be put to rest sometime; at least in this Circuit, it should be put to rest now ... the lower courts desperately need a clear answer."[11] The circuits are split in both the ultimate allowance of, and rationale for and against allowance of, prebankruptcy conduct releases for third parties. The cases can be divided into three broad categories:[12]

1. *Not Legally Permissible:* The Fifth, Ninth and Tenth Circuits have concluded that the bankruptcy court may not authorize prebankruptcy conduct releases for third parties (which they conflate with "discharges") outside of the asbestos context under § 524(g).[13]
2. *Permissible with Restrictions:* The Second,[14] Sixth and Seventh Circuits have concluded that §§ 105(a) and 1123(b)(6) provide bankruptcy judges with some "residual authority" to allow for third-party releases under certain circumstances (separating the concepts of discharge and third-party releases).[15]
3. *Legally Permissible:* The Third, Fourth and Eleventh Circuits have concluded that either § 105(a) authorizes prebankruptcy conduct releases for third parties or that there are factors to evaluate in deciding when it is appropriate to impose such a release.[16] In at least Delaware, nonconsensual third-party prebankruptcy conduct releases specifically concerning opioid claimants have been upheld as recently as Feb. 3, 2022.[17]

Economic Analysis: Show Me the Money!

"It has been more profitable for us to bind together in the wrong direction than to be alone in the right direction."
— Nassim N. Taleb, *The Black Swan* (2010)

While lawyers often argue incessantly over legal principles, the timely economic returns to constituents should be paramount in chapter 11 cases.[18] Those opposed to prebankruptcy conduct releases in bankruptcy cases to facilitate the collection of money as part of plan confirmation have often posited that despite optimistic projections, the actual claimants themselves rarely see any meaningful recovery. The money is absorbed by administrative costs and related expenses, but in the final analysis, the economic return to the claimants is where the focus should be.

A prebankruptcy conduct release, when applied to actors that have done bad acts, is the bankruptcy equivalent of prosecutors cutting an immunity deal for one bad actor to catch another (ostensibly worse) bad actor. It is not condoning what the immunized actor did, but rather is a real-world recognition that sometimes you let one bad actor off to achieve an imperfect, but greater, purpose. In the bankruptcy world, a timely economic return with certainty of sources of funds to pay claims to creditors is the greater purpose to be achieved. "Punishing" a bad actor often delays or can reduce that ultimate economic recovery.[19] The concept of prebankruptcy conduct releases is not all that dissimilar from settlements of class actions in other contexts (with the concept of opt-out rights dealt with herein). In this context, what is the recovery to claimants in class action cases?

A U.S. Chamber of Commerce study concluded that in the class-action settlements examined, the average class member's recovery was between 0.000006-12 percent of the claims, or an average of a mere $32.35 per claimant.[20] By contrast, the lawyers for the class recovered nearly $424,500 in fees.[21] The U.S. Chamber study further concluded that the vast majority of cases produced no benefit to most members of the putative class, and approximately 35 percent of the class actions were dismissed voluntarily by the plaintiffs after the plaintiff reached a private (*i.e.*, non-class) settlement with the defendant.[22]

It may be instructive to compare that return with the recovery to one well-known example of prebankruptcy conduct release cases: *Johns-Manville*.[23] In the 33 years since its creation, the Manville trust has processed about 1 million claims seeking in excess of $5 billion in total claims.[24] The trust contains assets currently in excess of $2 billion and is currently still paying claimants approximately 5.1 percent of requested claim amounts to

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10 *See* "Boy Scouts Bankruptcy Plan Hinges on Releases Deemed Illegal in *Purdue* Case," *Rochelle's Daily Wire* (Dec. 22, 2021), *available at* abi.org/newsroom/daily-wire.

11 SDNY Opinion at *4 (discussing lack of uniformity for third-party releases and need for clarity).

12 These are categorized for ease of reference, but the authors acknowledge that reasonable minds could create more nuanced categories. Moreover, even within a circuit, there may be differing categories. *See, e.g.*, n.16, *infra*. The SDNY Opinion did a masterful job of assembling the cases on this complex issue.

13 *See, e.g., Blixseth v. Credit Suisse*, 961 F.3d 1074, 1082 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021); *Bank of New York Tr. Co. NA v. Off. Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009); *In re W. Real Estate Fund*, 922 F.2d 592, 600 (10th Cir. 1990).

14 The Second Circuit may redefine what it finds appropriate or not should the SDNY Opinion go through the appellate process. The Second Circuit had previously held that nonconsensual third-party releases against nondebtors could be approved in narrow circumstances. *Deutsche Bank AG v. Metromedia Fiber Network Inc. (In re Metromedia Fiber Network Inc.)*, 416 F. 3d 136, 141 (2d Cir. 2005).

15 *See, e.g., In re Airadigm Commc'ns Inc.*, 519 F. 3d 640, 657 (7th Cir. 2008); *In re Dow Corning Corp.*, 280 F.3d 648, 663 (6th Cir. 2002).

16 *See, e.g., In re Seaside Eng'g & Surveying Inc.*, 780 F.3d 1070, 1078–81 (11th Cir. 2015); *Behrmann v. Nat'l Heritage Found. Inc.*, 663 F.3d 704, 712 (4th Cir. 2011); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 212-13 (3d Cir. 2000).

17 *See In re Mallinckrodt PLC*, Case No. 20-12522-JTD (Bankr. D. Del. Feb. 3, 2022) (Docket No. 6347) (approved releases for third parties with opt-out rights in plan, but also approved nonconsensual third-party prebankruptcy conduct releases as to opioid claimants based on necessity). *See also* "*In re Mallinckrodt PLC*: Delaware Bankruptcy Court Approves Non-Consensual Third-Party Releases in Contrast to *Purdue* and *Ascena*," V&E Restructuring & Reorganization Update (Feb. 14, 2022). Another Delaware bankruptcy judge denied confirmation of a plan with third-party prebankruptcy conduct releases on the basis that there was no showing that the releases were necessary or there was any contribution by the third parties getting the releases. *See* Rick Archer, "Judge Rejects 3rd-Party Releases in Cannabis Co. Ch. 11 Plan," *Law360* (Feb. 15, 2022). The authors speculate that while the third parties were disappointed in not getting their releases, they were just too mellow to care all that much.

18 A common criticism of chapter 11 is that it is too lengthy and expensive. While perhaps true, in complex dynamics such as those brought by mass tort issues, it is also perhaps an imperfect but necessary evil.

19 In releases of insurance companies, even if the insurance company is not contributing 100 percent of policy limits, the timeliness of the economic return from the contribution, plus the recognition that there might be diminution in the policy from costs of defense of the bad actors, would still be a greater good.

20 *See* Corporate Counsel, "Do Class Actions Benefit Class Members?," U.S. Chamber Report (Dec. 13, 2013). *See also* "FTC Study: Class Action Settlement Notices Have Room to Improve," Ballard Spahr Legal Alert (Oct. 2, 2019).

21 *Id.* at 2.

22 *Id.* at 3-4.

23 At the time the *Johns-Manville* plan (with its prebankruptcy conduct releases) was confirmed, § 524(g) was not in the Bankruptcy Code.

24 *See* Matt Mauney, "Johns-Manville," Asbestos.com/Mesothelioma Center (Aug. 23, 2021), *available at* asbestos.com/companies/johns-manville.

In Defense of Third-Party Releases in Chapter 11 Cases: Part II

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maintain liquidity.[25] By comparison to a traditional class-action settlement, this is one tangible example where a prebankruptcy conduct release for the benefit of third parties has returned a larger percentage to claimants than any traditional class-action settlement. To put it another way, it certainly is not worse than the recoveries to class action settlement claimants and has the added benefit that the entire claims-distribution process is transparent.

What's Wrong with the "God Clause"?

"E pur si muove."
— Galileo Galilei (1633)[26]

Opponents of prebankruptcy conduct releases are quick to point out that there is no express statutory authorization in the Bankruptcy Code for these releases (asbestos claims excepted), and that bankruptcy courts are left to rely on the equitable powers granted to bankruptcy courts under the amorphous provisions of § 105. In the words of one commentator, "Section 105(a) [is] sometimes referred to as the 'God clause,' which allows judges to exercise their equitable powers to issue any orders necessary or appropriate to carry out a bankruptcy plan."[27] Of course, there are also no express Code prohibitions or jurisdictional statutes, either.

The only express prohibition posited by some is the prohibition found in § 524(e), which conflates a discharge with a release and injunction. They are distinct legal issues and not tied together. The prebankruptcy conduct release is not a "discharge" of a third party (which is expressly prohibited), nor does the prebankruptcy conduct release flow from the debtor's discharge. It may have the same ultimate preclusive legal effect, but it is an injunction prohibiting actions against the third party based on that party's own liability.

The complexities of financial restructurings are such that having some leeway in implementing creative solutions should be encouraged, not discouraged. In the words of one bankruptcy judge, chapter 11 is unique in that it deals with what can be, not exclusively on what happened in the past (like traditional litigation).[28] Keeping flexibility for bankruptcy courts allows those courts to deal with real-time and real-world exigencies, which is critically important to the ultimate success of the chapter 11 process.

Why Are Some Prebankruptcy Conduct Releases Less Objectionable than Others?

"All animals are equal, but some animals are more equal than others."
— George Orwell, *Animal Farm* (1945)

Are those third parties who may have liability for asbestos-related injuries along with the debtor (and legally able to obtain a prebankruptcy-conduct release) somehow more deserving of relief than those related to mass tort damages that are not asbestos-related? Was § 524(g) just the result of a powerful asbestos-related insurance industry lobbying effort? Is there anything unique about mass tort situations in asbestos cases as compared with other product-liability or mass tort cases? It is unclear but also undeniable that the Code, as it currently exists, creates two distinct groups of third-party beneficiaries when it comes to the availability of prebankruptcy-conduct releases.

It must be presumed that Congress believed in 1994 that there was societal and economic benefit in amending § 524(g) to provide for a specific and detailed mechanism to get prebankruptcy-conduct releases in the asbestos context to nondebtor third parties in exchange for contribution to funding trusts for payment of these claims.[29] Presumably, such an amendment to the law was based on anticipated quicker, ratable payments to a deserving group of victims and incentivized third parties to "fund" trusts to administer such funds (the "carrot" being the prebankruptcy-conduct release). It is hard to argue against this change in the law.

Real-time case in point: J&J is currently facing about 38,000 personal-injury lawsuits, with new "ovarian cancer and mesothelioma lawsuits being filed at the rate of one per hour all day, every day in 2020."[30] In another opioid-producer's case, defense costs were estimated at as much as $1 million per week.[31] The tort-adjudication system in the U.S. has been characterized as "lottery-like" by J&J.[32] While J&J was characterizing this system from the perspective of astronomical jury verdicts in favor of plaintiffs (and against the company) taking years to come to judgment,[33] the flip side is also true: Those claimants that get judgments first stand a better chance of getting paid, but also ultimately reduce the "pot" available for later victims. Avoiding a rush to the courthouse may in practical effect benefit not just the company, but also the later victims (some of whom may not even know they have injury). The bottom line is that chapter 11 should be about equitable and ratable return and not just about payment to the first ones that get judgments.

The authors respectfully submit that the debate and litigation should center not on the legal issue about whether

25 *See* "Manville: MV Trust *Pro Rata* Increase," Claims Resolution Mgmt. Corp. (Feb. 18, 2021), *available at* www.claimsres.com/2021/02/18/manville-mv-trust-pro-rata-increase (*pro rata* trust distributions are adjusted periodically).

26 "Albeit it does move." Galileo purportedly muttered this phrase after Inquisition torturers forced him to recant his theory that the earth orbits the sun — deemed heresy by the church.

27 Sullivan, *supra* n.3, at 2.

28 Hon. **Redfield T. Baum** of the U.S. Bankruptcy Court for the District of Arizona (Phoenix).

29 Congress amended the Code to add § 524(g) in 1994 to "provide a restructuring model for asbestos-related bankruptcies." Susan Power Johnston & Katherine Porter, "Extension of Section 524(g) of the Bankruptcy Code to Nondebtor Parents, Affiliates, and Transaction Parties," *Bus. Lawyer*, Vol. 59, No. 2, pp. 510-11 (February 2004), *available at* jstor.org/stable/40688207. Section 524(g) provides for a specific and detailed procedure for the issuance of an injunction pursuant to a reorganization plan to cover, among other things, a third party (such as an insurance company or any other party who is alleged to be "directly or indirectly liable" with the debtor on asbestos-related claims).

30 J&J's subsidiary recently defeated a motion to dismiss its chapter 11 filing on bad faith grounds, with the bankruptcy court finding that chapter 11 is uniquely positioned to create a forum for the ratable distribution of assets for victims. *See* Vince Sullivan, "J&J Talc Unit's Ch. 11 Case Allowed to Go Forward," *Law360* (Feb. 25, 2022).

31 In opioid-producer Mallinckrodt PLC's chapter 11 case in Delaware, the litigation costs were estimated at $1 million per week. *See* "Horizontal 'Gifting' Approved in Mallinkrodt's Confirmed Chapter 11 Plan," *Rochelle's Daily Wire* (Feb. 9, 2022), *available at* abi.org/newsroom/daily-wire.

32 *Id.* (discussing how J&J was "already subject to 38,000 talc suits, with more accumulating every hour," and numbers clearly evidenced that company "could not bear the costs — let alone the lottery-like verdicts — of adjudicating the pending and expected claims").

33 *See* Vince Sullivan, "Talc Claimants Argue Bad Faith in J&J Ch. 11 Trial," *Law360* (Feb. 14, 2022) (49 talc claims had been tried at time J&J set up its new "Texas Two-Step" company to ring-fence liabilities, which cases took eight years to adjudicate with one jury verdict of $4.7 billion, reduced to $2 billion on appeal, in favor of 22 plaintiffs).

the third-party prebankruptcy conduct release is legally permissible, but rather the economic issue of how much it should cost the third party. That is what is critical to those with "skin in the game": certainty, timing and sources of payment, and efficiency of the process. This is certainly where *J&J* is attempting to steer the debate in its pending proceedings.[34] It is also clearly the focus of the ongoing *Purdue* settlement discussions.

The focus of the naysayers has been on the perceived benefit to the third parties of the prebankruptcy conduct release, when the real focus should be on the potential benefits to the victims of the mass tort.[35] Presumably, this is where Congress's focus was when it enacted § 524(g) in 1994. The allowance of pre-bankruptcy-conduct third-party releases resulting from *Johns-Manville* (which pioneered the concept before the Code expressly allowed it) was viewed as visionary enough that Congress formally adopted it for asbestos cases. The same concept is now being characterized as abusive.

It is time for Congress to address this disparity decisively. To that end, the authors humbly suggest four potential amendments to the Bankruptcy Code (title 11) and Judicial Code (title 28) that would create certainty in this uncertain jurisprudential morass. Stay tuned for Part III. abi

34 *See* Jonathan Randles, "J&J Could Increase $2 Billion Talc Settlement Offer, Lawyer Says," *WSJ Pro* (Feb. 16, 2022) (quoting from testimony in dismissal proceedings wherein J&J's bankrupt subsidiary stated that $2 billion being contemplated for settlement of claims is only "a start," subject to further negotiations).

35 The historic uses of chapter 11 to attempt to ring-fence liabilities (using a divisive merger or otherwise), and obtain discharges for debtors and third-party prebankruptcy conduct releases, have been the "abuses" of bankruptcy laws decried by numerous critics discussed herein. While making for expedient sound bites, it is also (in the authors' opinions) somewhat myopic. One can argue about changing the law, but at a minimum the full economic repercussions should be analyzed. If you increase taxes to companies and they move operations offshore, these same critics will complain about the loss of U.S. jobs. In economics, as in physics, every action has a reaction. It can be good, or not so good.

Feature

By Thomas J. Salerno and Clarissa C. Brady

In Defense of Third-Party Releases in Chapter 11 Cases: Part III

Four Proposed Fixes for the Third-Party-Release Mess!

Editor's Note: *This is the final installment of a three-part series.*

"We need to encourage habits of flexibility, of continuous learning, and of acceptance of change as normal...."
— Peter F. Drucker, *Innovation and Entrepreneurship: Practice and Principles* (1985)

Thomas J. Salerno
Stinson, LLP; Phoenix

Clarissa C. Brady
Stinson, LLP; Phoenix

Thomas Salerno is a partner with Stinson, LLP in Phoenix and a past ABI Vice President-Development. Clarissa Brady is an associate in the same office.

This series has reported the conundrum of third-party releases in chapter 11 cases.[1] In the first two installments, we defined the battlefield[2] and briefly explored the legal, policy and economic parameters of prebankruptcy conduct releases ("prebankruptcy conduct releases") to benefit nondebtor third parties.[3] We now suggest four potential legislative fixes to this prebankruptcy conduct release for third parties.

Remove the "Asbestos" Limitation from 11 U.S.C. § 524(g)(2)(B)(1)

Section 524(g) is an extensive and detailed blueprint for how to legally give prebankruptcy-conduct releases for nondebtor third parties for asbestos-related claims.[4] Why not simply take 14 words out of § 524(g) and keep all the other bells and whistles in it? Hence, the section as reworded would provide as follows:

> (B) The requirements of this subparagraph are that —
>
> (i) the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization —
>
> (I) is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages [*striking: allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products*][.]

If the Code were to be amended as proposed, it would provide the blueprint (with all the attendant protections and legal requirements) for prebankruptcy conduct releases for essentially any mass-tort type of claim group, not just asbestos-related claims. If it meets the due-process and societal-benefit hurdles for asbestos victims, why wouldn't it work for any mass-tort-type of situation?[5]

In addition, Congress should clean up another mess it created: Section 524(g) should be redesignated as a new § 1123(c) (dealing with permissive plan provisions). Including these third-party injunction provisions in § 524 only facilitated the conflating of the concepts of a prebankruptcy conduct release as a "discharge" of a nondebtor.[6] In legal reality, § 524(g)'s extensive provisions are not about "discharge" for nondebtors, but rather are a blueprint for an injunction benefiting third parties in the resolution of asbestos-liability claims in a chapter 11 plan context. It belongs conceptually and logically in § 1123.

Impose a Mandatory Opt-Out Option

Alternatively, an amended § 1123 could be further revised to expressly provide for mandatory provisions allowing creditors to opt out of the prebankruptcy-conduct release provisions in any plan. If reference to nonbankruptcy class action experience is any indication, there are empirical studies that show that opt-outs are statistically rare. In one study, for 2014-18, there were about 9 percent opt-outs in nearly 400 cases studied.[7]

Moreover, a plan that would have a mandatory opt-out could have a self-effectuating "poison pill" provision along with it. For example, unless XX percent in amounts of filed claims did not opt out, the contribution related to the prebankruptcy-

1 *See* Thomas J. Salerno & Clarissa C. Brady, "In Defense of Third-Party Releases in Chapter 11 Cases: Part I: Let's Define the Battlefield!," XLI *ABI Journal* 3, 32-33, 47, March 2022; Salerno & Brady, "In Defense of Third-Party Releases in Chapter 11 Cases: Part II: Show Me the Money, and What's Wrong with the 'God Clause'?," XLI *ABI Journal* 4, 30-31, 58-59, April 2022. Both articles are *available at* abi.org/abi-journal.
2 *See* Part I, *supra* n.1.
3 *See* Part II, *supra* n.1.
4 *Id.*
5 In practice, non-asbestos mass tort cases are already doing this. *See, e.g.*, Michael Mooney, "Courts Are Trying to Vet Boy Scout Sex Abuse Claims," *Axios* (Jan. 12, 2021) ("Last week, the preliminary tallies of a vote by alleged victims on whether to accept the most recent $2.7 billion settlement came just short of the 75 percent threshold the judge suggested to move forward.").
6 This anomaly in placement in the Code was specifically remarked upon by both the Sixth and Seventh Circuit decisions. *See* Part II, *supra* n.1.
7 *See* "Opt-Out Cases in Securities Class Action Settlements," Cornerstone Research: 2014-2018 Update.

conduct release would not be made, and all parties would reserve their rights. This would allow for plan confirmation to move forward, even if the class that would be most impacted by the prebankruptcy-conduct release opted out or the opt-outs were so large that they adversely affected the economics of the deal.[8]

It also presents the voting claimants with a real economic decision: Tie recovery to the third-party prebankruptcy-conduct release today, or wait another two to three years while the lawsuits play out and insurance policies are depleted by the costs of defense. The choice should belong to those with "skin in the game" in all events. Finally, such a provision puts the focus on where it really should be in these cases — negotiations and "horse trading" between those seeking the third-party release and those for whose benefit the contribution will be disbursed.[9]

Amend § 157 to Make Any Third-Party Prebankruptcy-Conduct Release a Matter for District Court Final Adjudication

The issue of legal propriety of third-party prebankruptcy-conduct releases is distilled (by the time it reaches appellate courts) to a distinct legal issue. Is there subject-matter jurisdiction for a bankruptcy court to grant these? With bankruptcy matters technically filed in district court (albeit automatically referred to the bankruptcy court), the constitutional quandary of subject-matter jurisdiction was solved. Bankruptcy matters are clearly matters of federal question jurisdiction under 28 U.S.C. § 1331, so district courts have subject-matter jurisdiction. Based on the referral by the district court, it is the bankruptcy court (as the "unit" of the district court) that exercises the jurisdiction subject to a detailed district court review regime discussed herein. Within the bankruptcy proceeding, title 28 further distinguishes between "core" (those matters expressly arising under the Bankruptcy Code) and "non-core" (those matters "related to" but not expressly arising under the matters in a bankruptcy proceeding).[10] Both core and non-core matters are automatically referred by the district court to the bankruptcy court for adjudication.

Even as an Article I court of limited jurisdiction, with respect to "core" matters (*e.g.*, stay relief), the bankruptcy court issues final and dispositive rulings with respect to those matters. Those are squarely in the bankruptcy court's grant of jurisdiction.

Conversely, as for "non-core" matters to which parties have not consented to jurisdiction, the bankruptcy court must propose *findings of fact and conclusions of law* for *de novo* review by the district court.[11] The district court (upon a party's request) reviews the proposed findings of fact and conclusions of law *de novo*, adopts or rejects (or some combination thereof) those proposed findings and enters final judgment. The *de novo* review means that no deference is afforded the bankruptcy court's factual findings, unlike in a traditional appeal (in which deference is afforded in an appeal in a core proceeding). An Article III judge has looked at the factual determinations and law with "fresh" Article III eyes. Constitutional problem solved. So, how about amending 28 U.S.C. § 157 by adding a new subsection that provides that the specific sections of any plan that contain a third-party prebankruptcy-conduct release being deemed "non-core," but related, matters, and as such a party will have the right to seek a *de novo* review of that specific provision to the district court?

The evidentiary record will be made at the bankruptcy court level and, with respect to the approval of that specific provision, the bankruptcy court will submit a proposed "report and recommendation" to the district court for *de novo* review. This standard will ensure that an Article III court with federal-question jurisdiction (the district court) makes the determination as to the appropriateness of the issuance of the injunction that enforces the prebankruptcy-conduct release.

This process will not take any more time than the current appeal process where there is objection to the approval of the prebankruptcy-conduct release, and ultimately the process would be expedited, since this process will do away with the major legal issue in the cases to date: the question of subject-matter jurisdiction to approve the releases.

While it is theoretically possible an objecting party will seek a new or additional evidentiary hearing before the district court as part of the *de novo* review process, it is simply unlikely that such a request would be granted absent extraordinary circumstances. A district court judge dealing with a full docket asked to review specialized matters of considerable complexity will be unlikely to reopen evidence absent very compelling circumstances. Moreover, given that the relief is essentially equitable in nature, jury trial rights are not implicated.[12]

Such a proposal, if adopted, could take away a powerful weapon in the plan proponent's arsenal: equitable mootness of plan confirmation order appeals. Absent a stay pending appeal, commencing plan distributions (and certainly substantially consummating plans) may equitably moot the appeal. While a possibility, in cases like *Purdue Pharma* there was little to no chance such a tactic would have worked (especially against any federal objecting governmental entities, to whom bonding requirements for stays are not applicable).[13]

Impose a Fulsome Financial Disclosure for All Recipients of Prebankruptcy Conduct Releases

Finally, and the least preferred from the authors' perspective, would be to statutorily impose on those third parties seeking a release to essentially submit to rigorous financial scrutiny with mandatory disclosures of financial information. This requirement would be akin to a best-interests-of-creditors

8 This mandatory opt-out is in some respects the flip side of the 75 percent consent requirement found in § 524(g)(2)(B)(iii)(IV)(bb) in asbestos cases.

9 The authors acknowledge that critics of this proposal will say that but for the appeal by the objecting states and those dissenters from the victim class, the Sacklers would have been able to get away with the initial $4.3 billion proposed contribution, and the additional contribution totaling up to $6 billion was only because of the serious legal impediment of the appeal. Perhaps so, but ultimately it was a negotiated resolution, which is the very core of chapter 11.

10 28 U.S.C. § 157(b).

11 28 U.S.C. § 157(c).

12 As the issuance of an injunction is inherently a matter in equity, jury trial rights are not afforded parties as a matter of right. *See, e.g., City of Monterey v. Del Monte Dunes at Monterey Ltd.*, 526 U.S. 687, 719 (1999).

13 *See, e.g.*, Fed. R. Bankr. P. 8007(d) (regarding no requirement for federal governmental agencies to post bond for stay pending appeal).

continued on page 89

In Defense of Third-Party Releases in Chapter 11 Cases: Part III

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test for the third-party beneficiary of the prebankruptcy conduct release, and would require a showing that such beneficiaries are providing more than claimants would get if the third party getting the release were itself in liquidation.[14] This is the least-preferred alternative, since it is the one most fraught with ancillary litigation possibilities and inherent delays. This would create a whole other set of litigation dynamics!

In any event, it is certainly better than an outright prohibition on such releases. In reality, it is somewhat similar to what bankruptcy courts are being asked to do when evaluating such releases currently (albeit with perhaps less precision). Equally unattractive would be to have the issue continue to percolate in the judicial system like the ongoing uncertainties revolving around the so called "new cash" exception (or corollary) to the absolute-priority rule. Like the "doctrine of necessity" for critical-vendor motions,[15] there is no statutory support in the Bankruptcy Code at all for this judicially created rule under § 1129(b)(2)(B)(ii) (indeed, it is violative of the Code's express provisions) and is the product of *dicta* in a pre-Code case from the 1930s.[16]

The Supreme Court has had two opportunities to rule on this very issue, but it managed to simply punt on it both times,[17] so it is still commonly used in chapter 11 cases. There is no statutory basis for this; rather, the Court determined that there was an "equivocality" in the Code provision to suggest that it might have survived the Code's enactment.[18] It seems that a reluctant Supreme Court looking to duck this issue could find sufficient wiggle room in the Code among §§ 105(a), 1123(a)(5) (requiring that a plan must provide for "adequate means of implementation") and 1123(b)(6) (stating that a plan may provide other provisions not expressly inconsistent with the Code). Leaving this impactful decision to the Court's vagaries solves little ultimately.

Last Word: Was the Sackler Deal Simply Not Rich Enough?

"Pigs get fat, hogs get slaughtered."
— "Rubbery Figures" (Australian TV Show from the 1980s)

Hon. Charles G. Case's characterization of the overarching purpose of chapter 11 speaks volumes: "The intent of the Bankruptcy Code is to encourage consensual resolution of claims through the plan negotiation process.... The Bankruptcy Court is a court of equity with a primary focus upon facilitating the reorganization process."[19] The "deal" that was memorialized in the *Purdue Pharma* plan garnered overwhelming creditor support. The subsequent deal that resulted in the objecting states' withdrawal of their objections sweetened the pot and added another $1.5 billion to the contribution being proposed. The process — as lengthy, expensive and contentious as it was — would undeniably fit within the Bankruptcy Code's intent. Hon. **Robert D. Drain** confirmed the plan (and approved the subsequent settlement), finding, *inter alia*, that they were acting in good faith.

It is interesting that the creative professionals that conceived of and implemented the *Johns-Manville* plan (using a Code that had no express provisions for such a process) are hailed as pioneering visionaries in the asbestos mass tort world, yet attempts to use the same basic protocol for non-asbestos injuries are decried as perverting and abusing the Code and process.

Given the beneficiaries of the *Purdue Pharma* releases and the political heat the issue has caused, the positions of the various objecting states were certainly foreseeable. As the Sackler family releases as originally proposed would result in essentially a retention of about 60 percent of the wealth upstreamed from *Purdue Pharma*, was the issue exacerbated by the dynamic that the deal was simply not rich enough (despite the widespread and overwhelming creditor support)? As Hon. Colleen McMahon candidly observed, "Judge Drain was certainly right about one thing: where the Objecting States are concerned, it really is all about the money, specifically how much money the Sacklers are prepared to pay to 'buy peace.'"[20]

Jurisdictional and philosophical objections aside, the true issue was undeniably that the Sacklers were simply not paying enough for the releases. It was an economic impasse wrapped in a legal flag. In the end, it was about how much more the objecting states needed earmarked for them and their efforts in dealing with the aftermath related to opioid addiction.[21]

In the sausage-making that is chapter 11 plan negotiations, the real litmus test should be time and expenses (legal fees and costs) saved, and measuring those against the potential chapter 7 of the person/entity seeking the release. This is easier said than done, but spending enormous resources on the battles surrounding the legality of prebankruptcy conduct releases can also lead to a Pyrrhic victory for the winner of that fight.

In all events, the *Purdue Pharma* deal was an imperfect solution to a very messy problem. The ball should be in the legislative court to definitively resolve this issue. Let's get this mess fixed. Indeed, one amendment to § 524(g) and/or to 28 U.S.C. § 157 could accomplish that. Let's finish this already! abi

14 Admittedly, one might counter by asking, why not have the beneficiary simply file their own bankruptcy? The specter of additional administrative expenses and delay in such a situation would militate against this.
15 *See* Part II, *supra* n.1.
16 *See Case v. Los Angeles Lumber*, 308 U.S. 106 (1939); *cf., In re Ambanc La Mesa Ltd. P'ship*, 115 F.3d 650 (9th Cir. 1997) (recognizing continued viability of new cash exception), *with In re Coltex Loop Central 3 Partners LP*, 138 F.3d 39 (2d Cir. 1998); *In re Bryson Props. XVIII*, 961 F.2d 496 (4th Cir. 1992) (holding that new-cash exception did not survive Bankruptcy Code's enactment).
17 *See Bank of Am. v. 203 N. LaSalle P'ship*, 526 U.S. 434 (1999); *Norwest Bank Worthington v. Ahlers*, 45 U.S. 197 (1988).
18 *203 N. LaSalle* at 435 ("The drafting history is equivocal, but does nothing to disparage the possibility apparent in the statutory text, that § 1129(b)(2)(B)(ii) may carry such a corollary. Although there is no literal reference to 'new value' in the phrase 'on account of such junior claim,' the phrase could arguably carry such an implication in modifying the prohibition against receipt by junior claimants of any interest under a plan while a senior class of unconsenting creditors goes less than fully paid.").
19 *In re Rhead*, 179 B.R. 169, 176 (Bankr. D. Ariz. 1995) (Case, B.J.) (citations omitted). This is in no way intended to suggest that Judge Case (now retired) would agree with the use of his words in this specific context.
20 Appeal Certification Order at 2, n.1.
21 *See* Hailey Konnath, "NY, NJ Towns Fight $277M 'Hush Money' in Purdue Deal," *Law360* (March 7, 2022); Paul Schott, "CT Attorney General Denies 'Ignoring' Opioid Victims' Families in Purdue Pharma Appeal," *CT Insider* (Jan. 12, 2021).

ABI EXCLUSIVE

JANUARY 20, 2023

Tenth Circuit Doesn't Pay '13' Trustee if Dismissal Precedes Confirmation

> The first court of appeals to rule on a question where lower courts are split, the Tenth Circuit finds the statute unambiguous and requires a chapter 13 trustee to disgorge his or her fee if the case is dismissed before confirmation.

The first court of appeals to rule on a question where the lower courts are widely split, the Tenth Circuit held that a chapter 13 trustee was not entitled to payment of her fee because the case was dismissed before confirmation of a plan.

Although the Bankruptcy Code does not expressly answer the question, the January 18 opinion by Circuit Judge David M. Ebel found the statutes to be unambiguous, in favor of requiring trustees to disgorge fees if the chapter 13 case was dismissed before confirmation. He was particularly persuaded to rule in favor of the debtor because the Bankruptcy Code explicitly says that trustees retain their fees in Subchapter V and chapter 12 if the case was dismissed before confirmation.

Typical Facts

The facts were typical of cases where the courts come down both ways. The debtor filed a chapter 13 petition and slogged through four iterations of a plan over 18 months. After the bankruptcy court denied confirmation of the fourth plan, the court dismissed the case.

While the case was pending, the debtor had paid the trustee almost $30,000 toward what would have been distributions to creditors and other plan payments. Following dismissal, the chapter 13 trustee paid the debtor's counsel almost $20,000 on an allowed fee application and distributed another $7,500 in payment of a priority tax claim. Toward partial payment of the chapter 13 trustee's fee, the bankruptcy court allowed the trustee to retain the remainder, some $2,600.

With $2,600 in controversy, the debtor appealed. The district court reversed in December 2021, requiring the chapter 13 trustee to refund the $2,600 to the debtor. *Doll v. Goodman (In re Doll)*, 21-00731, 2021 BL 464213, 2021 WL 5768991 (D. Colo. Dec. 6, 2021). To read ABI's report, **click here**.

Supported by an amicus brief from the National Association of Chapter 13 Trustees, the chapter 13 trustee appealed. The debtor found support in an *amicus* brief from three organizations on the side of debtors.

The Statute Is Not Ambiguous

Admirably, Judge Ebel traced the history of chapter 13 trustees, how they were delegated responsibilities previously thrust on courts, and why they were given fixed fees rather than allowances to be made by the court in every case. He explained how and why the fees paid to chapter 13 trustees are too low in some cases and too high in others.

Judge Ebel laid out the relevant statutes, particularly 28 U.S.C. § 586(e) and Section 1326(a)(1) and (a)(2).

Section 586(e) says that a standing trustee "shall *collect* such percentage fee from all payments . . . under [chapter 13] plans. . . ." [Emphasis added.]

Section 1326(a)(1) requires a chapter 13 debtor to commence making payments to the trustee within 30 days of filing. Subsection (a)(2) provides that payments made by the debtor "shall be retained by the trustee until confirmation or denial of confirmation. . . . If a plan is not confirmed, the trustee shall return any such payments not previously paid . . . to creditors . . . , after deducting any unpaid claim allowed under section 503(b)." The subsection says nothing explicitly about the standing trustee's fee if the case was dismissed before confirmation.

Judge Ebel said that the "question presented here is resolved unambiguously by reading together both 28 U.S.C. § 586 and 11 U.S.C. § 1326." He added that the language in Section 1326(a)(2) is "straightforward."

He read Section 1326(a)(2) "to mean that the standing trustee must return all of the pre-confirmation payments he receives, without first deducting his fee." He found "no indication in this statutory language that the trustee should first deduct his fees before returning the pre-confirmation payments to the debtor when no plan is confirmed."

Judge Ebel "bolstered" his conclusion by noting how Congress expressly allowed trustees in chapter 12 and Subchapter V cases to retain their fees if the cases were dismissed before confirmation. *See* Sections 1194(a) and 1226(a). He found the "differing treatment" of chapter 13 trustees to be "compelling" and "persuaded [him] that Congress intended that Chapter 13 standing trustees not deduct their fees before returning pre-confirmation payments to the debtor when a plan is not confirmed."

Drawing inferences from the differences in the statutes, Judge Ebel said:

> Giving effect to §§ 1194(a)(3) and 1226(a)(2)'s express direction that standing trustees in Chapter 12 and Chapter 11 (Subchapter V) cases should deduct their fees from pre-confirmation payments before returning them to the debtor when no plan is confirmed suggests that

> Congress did not intend Chapter 13 standing trustees to do the same where such language is omitted.

Judge Ebel held that:

> 11 U.S.C. § 1326(a), read together with 28 U.S.C.§ 586(e)(2), and considered in light of the different language in 11 U.S.C. §§ 1194(a)(3) and 1226(a)(2), unambiguously require the standing Chapter 13 trustee to return pre-confirmation payments to the debtor without the trustee first deducting his fee, when a proposed Chapter 13 reorganization plan is not confirmed.

Judge Ebel ended his opinion rejecting arguments proffered by the trustee that had been espoused by other courts ruling to the contrary.

The word "collect" in Section 526(e) "cannot mean," Judge Ebel said, "that the act of 'collection' of funds irrevocably constitutes a payment to the Trustee of his fees." Likewise, he said that language in the *Chapter 13 Trustee Handbook* was "hardly the exercise of agency expertise in interpreting an ambiguous statute or filling a regulatory gap left by Congress to which a court usually defers."

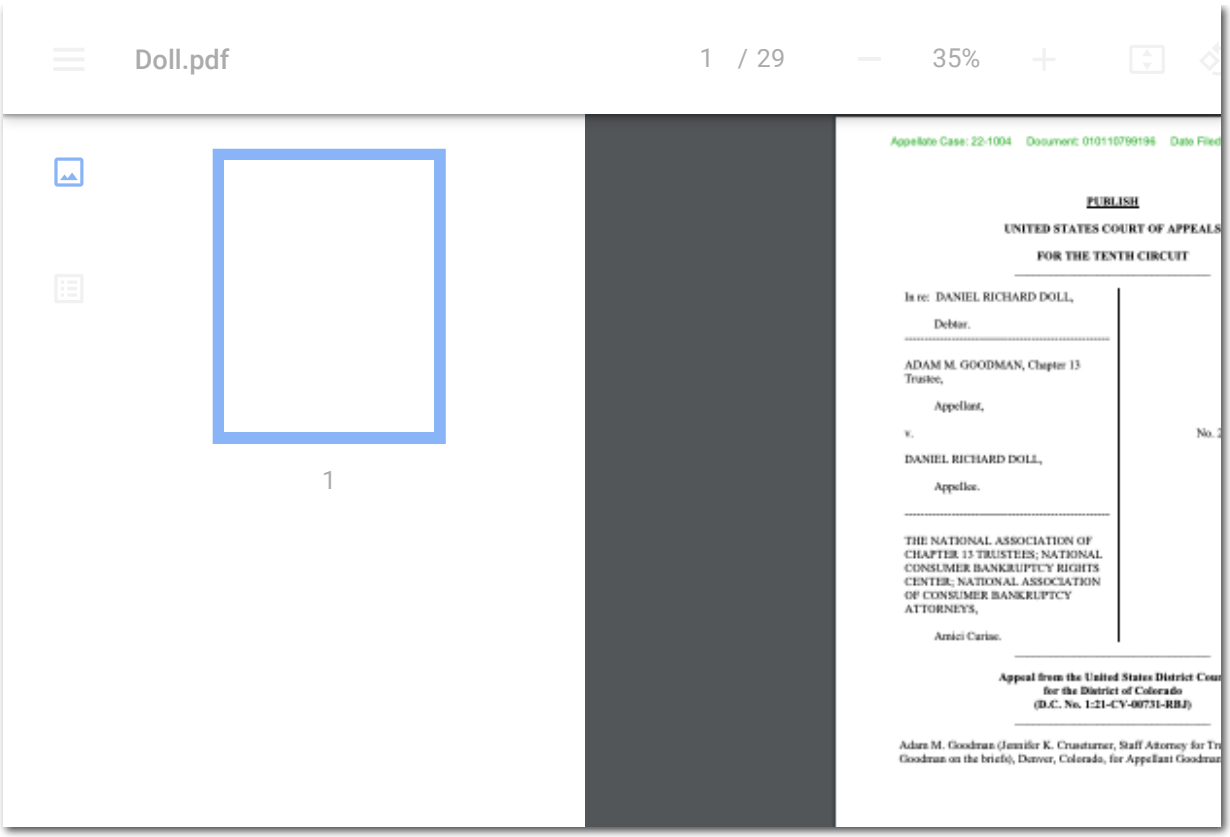
Judge Ebel ended his opinion by saying that he "need not decide here whether the Handbook is entitled to any sort of deference because the statutory language at issue here is unambiguous."

Recent Contrary Authority

The district and bankruptcy courts are split. In a decision last year, a district court in Idaho found no ambiguity in the statute but concluded that the trustee was entitled to retain the fee. *See McCallister v. Evans*, 637 B.R. 144 (D. Idaho Feb. 8, 2022). To read ABI's report, **click here**.

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Doll.pdf

Case Details

Case Citation	Goodman v. Doll (In re Doll), 22-1004 (10th Cir. Jan. 18, 2023).
Case Name	Goodman v. Doll (In re Doll)
Case Type	Consumer
Court	10th Circuit
Bankruptcy Tags	Professional Compensation/Fees Consumer Bankruptcy

Individual Chapter 13 Filings Increase 32 Percent in Calendar Year 2022

Individual Chapter 13 Filings Increase 32 Percent in Calendar Year 2022

Total Bankruptcy Filings Down 6 Percent

Jan. 5, 2023 – Individual Chapter 13 bankruptcy filings during calendar year 2022 (Jan. 1-Dec. 31) increased 32 percent to 149,072 from the 2021 total of 112,913, according to data provided by Epiq Bankruptcy, the leading provider of U.S. bankruptcy filing data. While representing a substantial year-over-year increase, individual Chapter 13 filings remain lower than the pre-pandemic total of 272,451 recorded in calendar year 2019.

Overall individual filing totals for calendar year 2022 were down six percent to 356,930 from the 378,918 individual filings the previous year. Individual filings are at their lowest levels since the 341,233 filings registered in 1985.

The 378,326 total bankruptcy filings in calendar year 2022 also registered a six percent decrease from the 401,479 filings during calendar year 2021. Annual bankruptcy filings last registered a similar total in 1984, with 348,521 total filings. Commercial filings also declined, as 21,396 filings in calendar year 2022 represented a five percent drop from the 22,561 filings recorded in calendar year 2021.

Commercial Chapter 11 filings increased 2 percent to 3,816 in calendar year 2022 from the previous year's total of 3,726. Subchapter V elections within Chapter 11 also experienced an increase in calendar year 2022, as the 1,433 filings represented a 13 percent jump from the 1,263 filings recorded in 2021.

"The underlying data tells different year-over-year economic stories. The Chapter 7 story is encouraging with new filings down 21.6 percent. The Chapter 11/11V story is business as usual

with new filings slightly up 1.2 percent, and the Chapter 13 story looks bleak as new filings were up 32 percent," said **Gregg Morin**, VP Business Development and Revenue for Epiq Bankruptcy. "But if you are in the bankruptcy servicing business there is still another story as all three chapters had more cases close in 2022 than new cases filed. Chapter 7 filings had 29,799 more cases closed than opened, Chapters 11/11V had 265 more closed, and Chapter 13s had 44,361 more closed. Every month in 2022, all chapter totals had more cases close than open totaling 74,678 for the year, continuing the annual trend since 2011," Morin added.

"Steep bankruptcy filing declines abated over the past year as pandemic assistance programs and lender forbearance receded while interest rates, inflationary pressures and debt loads grew," said ABI Executive Director **Amy Quackenboss**. "As struggling families and companies face mounting economic pressures at the start of 2023, bankruptcy provides a proven shield toward a financial fresh start."

All filing categories registered an increase in December 2022 compared to the previous year. Total bankruptcy filings increased six percent to 29,631 in December over the 27,997 total filings in December 2021. The 27,919 individual filings also represented a six percent rise over the 26,306 filings in December 2021. Total commercial filings for December were 1,712, an increase of one percent over the 1,691 total commercial filings in December 2021. Commercial Chapter 11 filings increased 3 percent to 326 in December 2022 from the 316 filings in December 2021. December 2022 subchapter V small business filings registered the largest increase — 51 percent — as the 128 subV elections were double the 84 registered in December 2021. While still below pre-pandemic levels, individual Chapter 13 filings continued to increase in December as well, as 12,397 filings were up 24 percent over the December 2021 total of 10,028.

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Thursday, January 5, 2023

Article Tags: Consumer Bankruptcy Business Reorganization

Feature

By Edward Neiger and David Stern

The Evolution of Future Claims Representatives

Edward Neiger
ASK LLP; New York

David Stern
ASK LLP; St. Paul, Minn.

Edward Neiger is co-managing partner of ASK LLP in New York and oversees the firm's Bankruptcy, Mass Tort and Personal Injury Divisions. He is also a 2019 ABI "40 Under 40" honoree. David Stern is an associate in the firm's St. Paul, Minn., office and represents clients in mass tort bankruptcy litigation.

A future claims representative (FCR) is a person in a mass tort bankruptcy who is "appointed to represent and protect the interests of persons with future unknown claims."[1] Appointed by the bankruptcy court,[2] an FCR is paid by the debtor's estate, upon court approval.[3] The FCR's statutory role is "protecting the rights of persons that might subsequently assert demands,"[4] and typical tasks may include familiarizing themselves with the debtor's insurance, business affairs, assets and liabilities, relationships and "other due diligence items," as well as handling negotiations regarding a potential reorganization plan.[5]

An FCR is considered a party-in-interest under 11 U.S.C. § 1109(b) and has all of the powers and duties of a committee as set forth in 11 U.S.C. § 1103.[6] This person can hire professionals with prior court approval,[7] and can compel the production of information.[8] An FCR can appeal court orders[9] and object to plan confirmation.[10]

This article explores the evolution of the FCR, from its judicial creation to its codification and its further judicial expansion. This article also analyzes how courts have dealt with potential future claims in three pending cases, and provides a cautionary note on expanding the FCR role too broadly.

First FCR in Bankruptcy: Creature of Judicial Construction

The first use of an FCR in a bankruptcy was the first mass tort bankruptcy, *In re Johns-Manville Corp*.[11] In this case, the debtor wanted to discharge its past and future asbestos liability,[12] but asbestos has a long latency period, with injuries sometimes taking decades to manifest.[13] Thus, the court appointed a representative to advocate for the interests of people who had been exposed to the debtor's asbestos but had not yet manifested symptoms.[14] At the time, the Bankruptcy Code did not overtly permit FCRs, so the *Johns-Manville* court justified appointing an FCR by citing state court cases demonstrating the "inherent" power "in every court" to appoint "some kind of representative for parties-in-interest whose identities are yet unknown."[15]

Enactment of FCRs in Asbestos Mass Tort Bankruptcies

Congress amended the Bankruptcy Code in 1994 by enacting § 524(g) to explicitly permit the format of the *Johns-Manville* bankruptcy for future asbestos cases, including the use of FCRs.[16] Although the phrase "future claims representative" does not appear in § 524(g) or elsewhere in the Code, it is well established that § 524(g)(4)(B) requires their use in asbestos bankruptcies utilizing channeling injunctions.[17] The Code only explicitly permits FCRs in chapter 11 asbestos bankruptcies,[18] and Congress was intentionally neutral regarding whether courts could use § 524(g)'s tools in non-asbestos cases.[19]

Bankruptcy Courts Expanded FCRs Beyond Asbestos Mass Tort Bankruptcies

Just as a court created the first FCR before the Bankruptcy Code explicitly permitted it, bankruptcy courts expanded the use of FCRs beyond the asbestos context to which § 524(g) explicitly applies. In 1988, years before § 524(g)'s enactment, a bankruptcy court appointed an FCR in a case involv-

1 *See Wright v. Owens Corning*, 679 F.3d 101, 108 n.7 (3d Cir. 2012).
2 11 U.S.C. § 524(g)(4)(B)(i).
3 *See* Order Appointing Roger Frankel, as Legal Representative for Future Opioid Personal Injury Claimants, Effective as of the Petition Date, *In re Mallinckrodt PLC*, Case No. 20-12522-JTD (Bankr. D. Del. June 11, 2021) (hereinafter the "Frankel Appointment Order").
4 11 U.S.C. § 524(g)(4)(B)(i).
5 *See* Debtors' Motion for Entry of an Order Appointing James L. Patton, Jr., as Legal Representative for Future Claimants, *Nunc Pro Tunc* to the Petition Date at Ex. C, *Boy Scouts of Am.*, Case No. 20-10343-LSS (Bankr. D. Del. March 18, 2020).
6 *See* Order Appointing James L. Patton, Jr., as Legal Representative for Future Claimants, *Nunc Pro Tunc* to the Petition Date, *In re Boy Scouts of Am.*, Case No. 20-10343-LSS (Bankr. D. Del. April 24, 2020) (hereinafter the "Patton Appointment Order").
7 *See In re Imerys Talc Am. Inc.*, Case No. 19-10289, 2020 WL 6927654, at *1, *4 (Bankr. D. Del. Nov. 20, 2020) (citing 11 U.S.C. §§ 105(a), 330, 331, 524(g)).
8 *See* Fed. R. Bankr. P. 2004.
9 *In re Bestwall LLC*, Case No. 3:20-cv-105-RJC, 2022 WL 68763, at *1, *4 (W.D.N.C. Jan. 6, 2022).
10 *See In re Flintkote Co.*, 486 B.R. 99, 111 (Bankr. D. Del. 2012) ("Parties-in-interest also have standing to object to confirmation of a plan.").
11 68 B.R. 618 (Bankr. S.D.N.Y. 1986), *aff'd sub nom., Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988).
12 *See In re Johns-Manville Corp.*, 36 B.R. 743, 745-46, 749 (Bankr. S.D.N.Y. 1984).
13 *Id.* at 745.
14 *Id.* at 749, 759.
15 *Id.* at 758-59.
16 *See* 11 U.S.C. § 524(g)(4)(B)(i); *In re Combustion Eng'g Inc.*, 391 F.3d 190, 235 n.47 (3d Cir. 2004).
17 *See In re Energy Future Holdings Corp.*, 949 F.3d 806, 812 (3d Cir. 2020).
18 *See Combustion Eng'g*, 391 F.3d at 234 nn.45, 46 (quoting 11 U.S.C. §§ 524(g)(1)(A), 524(g)(2)(B)(i)(I), (ii)(I-III), 524(g)(4)(B)(i)).
19 *See* 140 Cong. Rec. H10752, 10766 (daily ed. Oct. 4, 1994) ("The Committee expresses no opinion as to how much authority a bankruptcy court may generally have under its traditional equitable powers to issue an enforceable injunction of this kind. The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved. How the new statutory mechanism works in the asbestos area may help the Committee judge whether the concept should be extended into other areas.").

ing personal injuries from intrauterine devices.[20] Courts have been appointing FCRs in cases involving non-asbestos injuries with long latency periods ever since.[21] When courts appoint FCRs in bankruptcies that are unrelated to asbestos, they generally cite 11 U.S.C. §§ 105(a) and 1109(b) as the statutory authorities.[22]

FCRs Protect the Due-Process Rights of Future Claimants

The Fifth Amendment's safeguard that "[n]o person shall ... be deprived of life, liberty, or property without due process of law"[23] extends to bankruptcy. One court reasoned that "[t]he bankruptcy power is subject to the Fifth Amendment."[24] Meanwhile, the Bankruptcy Code is "founded in fundamental notions of procedural due process."[25] Another court noted that "[d]ue process requires notice that is 'reasonably calculated to reach all interested parties, reasonably conveys all the required information, and permits a reasonable time for a response.'"[26]

At its foundation, the purpose of an FCR is to protect future claimants' due-process rights.[27] The concern is that without pushback from an FCR, current creditors would consume all of the debtor's available resources, leaving nothing for future creditors.[28] Some courts have held that a restructuring with no FCR violated future claimants' due-process rights such that the debtor never discharged its liability to them.[29]

A Potent Tool on the Edge of Due Process

Three currently pending bankruptcies illustrate how the interests of future creditors were protected. *In re Boy Scouts of America*[30] is an example of the appropriate use of an FCR in a non-asbestos case. Courts recognize that survivors of childhood sexual abuse sometimes repress their memories of the abuse.[31] In the *Boy Scouts* case, cognizant of how childhood sexual abuse can impact memory, the court appointed an FCR with a narrow scope of representation: to only represent survivors who were sexually abused after the debtor filed for bankruptcy and did not file a proof-of-claim form by the bar date, and either were not 18 years old by the bar date or were not aware of the sexual abuse because they repressed their memory of it, if the concept of repressed memory is recognized by the highest court of the jurisdiction where the abuse occurred.[32] The *Boy Scouts* court joined a line of sexual abuse cases appointing FCRs in a creative and properly limited fashion.[33]

> **Courts should continue appointing FCRs in cases primarily discharging liability for injuries with long latency periods or in cases where they are otherwise absolutely necessary.**

In re Mallinckrodt[34] is an example of a case where an FCR might not have been absolutely necessary because of the short latency period of opioid addiction, but the court appointed one anyway, upon the agreement of all major parties. Mallinckrodt manufactures opioids[35] and wanted to discharge its past and future liability for harm its opioids caused.[36] The company was successful in getting the court to appoint an FCR.[37] Mallinckrodt likely moved to appoint an FCR to reduce the ability of future claimants to litigate against it for opioid liability.[38] The whole point of an FCR is to protect the due-process rights of future claimants whose injuries have not yet manifested due to a long latency period.[39] However, common opioid injuries have a short latency period, and it takes only a "couple of weeks" to get addicted to opioids.[40] In addition, an overdose can occur "minutes to hours after the drug was used."[41]

The use of an FCR when not absolutely necessary may handicap the interests of the debtor's current creditors and ultimately may harm the institution of the FRC itself, even in cases where it is absolutely necessary. This is particularly true in non-asbestos cases where there is no statutory precedent for FCRs. For example, the continued expansion of "nonconsensual third-party releases" in cases where they were not absolutely necessary has harmed the concept itself, even in cases where they were broadly supported and absolutely necessary, such as in the *Purdue Pharma* bankruptcy,

20 *See In re A.H. Robins Co. Inc.*, 88 B.R. 742, 742-44 (E.D. Va. 1988).
21 *See In re Eagle-Picher Indus. Inc.*, 203 B.R. 256, 261, 267 (S.D. Ohio 1996) (appointing FCR for future claims caused by asbestos and lead); *In re Hoffinger Indus. Inc.*, 307 B.R. 112, 115 (E.D. Ark. 2004) (appointing FCR for future claims caused by swimming pools and pool accessories).
22 *See, e.g.*, Patton Appointment Order 2-3 (citing 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); 11 U.S.C. § 1109(b) ("A party-in-interest ... may raise and may appear and be heard on any issue in a case under this chapter.").
23 U.S. Const. amend. V.
24 *U.S. v. Security Indus. Bank*, 459 U.S. 70, 74 (1982).
25 *In re HNRC Dissolution Co.*, 3 F.4th 912, 927 (6th Cir. 2021) (quoting *In re Savage Indus. Inc.*, 43 F.3d 714, 721 (1st Cir. 1994)).
26 *See Jones v. Chemetron Corp.*, 72 F.3d 341, 346 (3d Cir. 1995) (quoting *Greyhound Lines Inc. v. Rogers (In re Eagle Bus Mfg. Inc.)*, 62 F.3d 730, 735 (5th Cir. 1995)).
27 *See Jones v. Chemetron Corp.*, 212 F.3d 199, 209 (3d Cir. 2000) ("[D]ue-process considerations are often addressed by the appointment of a representative to receive notice for and represent the interest of a group of unknown creditors.").
28 *See In re Amatex Corp.*, 755 F.2d 1034, 1042-43 (3d Cir. 1985) (noting that creditors' committee "comprised of asbestos claimants whose injuries had already manifested" opposed creation of FCR because "if future claimants are excluded from the reorganization plan, the current claimants will receive a larger portion of an obviously limited fund").
29 *See In re Grumman Olson Indus. Inc.*, 467 B.R. 694, 710 (Bankr. S.D.N.Y. 2012) ("[T]here was not a future claims representative in this case, or any provisions made for unrepresented future claimants. Thus, [future claimants] ... were not afforded either the notice and opportunity to participate in the proceedings or representation in the proceedings that due process would require in order for them to be bound by the Bankruptcy Court's orders."); *Chemetron*, 212 F.3d at 209 ("[I]f a potential claimant lacks sufficient notice of a bankruptcy proceeding, due process considerations dictate that his or her claim cannot be discharged by a confirmation order."); *In re Chance Indus. Inc.*, 367 B.R. 689, 708-10 (Bankr. D. Kan. 2006).
30 No. 20-10343-LSS (Bankr. D. Del.).
31 *See Clark v. Edison*, 881 F. Supp. 2d 192, 201–17 (D. Mass. 2012); *Isley v. Capuchin Province*, 877 F. Supp. 1055, 1055-67 (E.D. Mich. 1995).
32 *See* Patton Appointment Order ¶ 4.
33 *See, e.g., In re Roman Catholic Archbishop of Portland in Oregon*, Case No. 04-37154-ELPLL, 2005 WL 148775, at *1 (Bankr. D. Ore. Jan. 10, 2005); Order Authorizing Appointment of Future Claimants' Representative and Appointing Fred C. Caruso as Future Claimants' Representative ¶ 2, *In re USA Gymnastics*, Case No. 18-09108-RLM-11 (Bankr. S.D. Ind. May 17, 2019) (hereinafter the "Caruso Appointment Order").
34 Case No. 20-12522 (JTD) (Bankr. D. Del. 2020).
35 *See* Declaration of Stephen A. Welch, Chief Transformation Officer in Support of Chapter 11 Petitions and First Day Motions ¶¶ 12, 71-72, *Mallinckrodt*, Case No. 20-12522 (JTD) (Bankr. D. Del. Oct. 12, 2020).
36 *Id.* at ¶¶ 68, 83, 91, 93.
37 *See* Frankel Appointment Order.
38 *See Grumman Olson*, 467 B.R. at 710; *Chemetron*, 212 F.3d at 209; *Chance*, 367 B.R. at 708-10.
39 *See Chemetron*, 212 F.3d at 209; *Amatex*, 755 F.2d at 1042-43.
40 "The Science of Addiction: Can Opioids Be Taken Responsibly," John Hopkins Medicine, *available at* hopkinsmedicine.org/opioids/science-of-addiction.html (unless otherwise specified, all links in this article were last visited on Sept. 19, 2022).
41 "Overdose Education," Boston University School of Medicine, Clinical Addiction Research & Education Unit, *available at* www.bumc.bu.edu/care/research-studies/project-recover/overdose-education.

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The Evolution of Future Claims Representatives

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where the district court reversed a broadly supported plan on the basis that it contained nonconsensual third-party releases.[42] Since nonconsensual third-party releases and FCRs have the same legislative and judicial history, a pertinent lesson should be learned: The overuse of the FCR may ultimately be its downfall.

Interestingly, the *Purdue Pharma* cases provided a unique and novel way of dealing with the problem of future claims with short latency periods. In *In re Purdue Pharma LP*,[43] the court never appointed an FCR, as no party requested it. Instead, the court imposed a claims bar date,[44] and to deal with future claims, the debtor set aside $5 million. After a given period of time, any unused portion of such amount will revert to the trust for current victims.[45]

Conclusion

Courts should continue appointing FCRs in cases primarily discharging liability for injuries with long latency periods or in cases where they are otherwise absolutely necessary. However, expanding the scope of the FCR by appointing them in every case with tort creditors may ultimately backfire and hurt future claimants, even in cases where an FCR is eminently appropriate. abi

42 *See* Decision and Order on Appeal at 7, 141-42, *In re Purdue Pharma LP*, Case No. 21-cv-7532 (CM) (S.D.N.Y. Dec. 16, 2021) (vacating bankruptcy court's confirmation order because plan contained nonconsensual third-party releases), *appeal pending*, Case No. 22-110 (2d Cir. Feb. 18, 2022).

43 Case No. 19-23649 (SHL) (Bankr. S.D.N.Y. 2019).

44 *See* Order Establishing (I) Deadlines for Filing Proofs of Claim and Procedures Relating Thereto, (II) Approving the Proof of Claim Forms, and (III) Approving the Form and Manner of Notice Thereof 1-16, *Purdue*, Case No. 19-23649 (RDD) (Bankr. S.D.N.Y. Feb. 3, 2020).

45 *See* Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma LP and Its Affiliated Debtors § 5.7(f), *Purdue*, Case No. 19-23649 (RDD) (Bankr. S.D.N.Y. Sept. 2, 2021); Findings of Fact, Conclusions of Law, and Order Confirming the Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma LP and Its Affiliated Debtors § R.R.(c)-(d), *Purdue*, Case No. 19-23649 (RDD) (Bankr. S.D.N.Y. Sept. 17, 2021).

Dicta

By Hon. Cecelia G. Morris[1]

Expectations of a Veteran Judge

Hon. Cecelia G. Morris
U.S. Bankruptcy Court (S.D.N.Y.); Manhattan, Poughkeepsie and White Plains

Hon. Cecelia Morris began her official tour of duty as U.S. bankruptcy judge for the Southern District of New York on July 1, 2000, and served as chief judge from March 1, 2012, until March 1, 2022.

This article's purpose is simple:[2] to remind lawyers, regardless of the dollar amount or significance of the case, of the basic decorum and expectations for presentations to be heard by the court, whether in person, by video or by telephone. By its very nature, presentation requires thinking ahead. Beginning with client intake, you need to be thinking about options for the filing and form a plan for how to handle any issues on the horizon. No matter how large or small the case, a skilled lawyer, no matter the party you are representing, will assess the needs of judicial opinion and the potential for litigation, trial and appeals — even at this early point.

The Commencement of the Case

Filing a bankruptcy petition always requires an initial choice. While most bankruptcy attorneys know about the choice between filing under chapters 7 and 13, when representing an entrepreneurial debtor, you should also consider using subchapter V of chapter 11. This provision has expanded the choice for debtors with personal commercial and business debt.

Where you file may be as important as how you file. In larger cases, it is necessary to inquire where the debtor has commercial contacts and which choice of venue would meet the needs of your client. Once the option of filing in different bankruptcy courts is ascertained, consider how the district and circuit courts within that venue handle issues that may arise once the case is filed.[3]

While a consumer debtor is limited in their choice of venue, the debtor's attorney would be wise to educate themselves on how the bankruptcy, district and circuit courts handle issues related to any potential contested matters. Having that knowledge gives you more control during negotiations and empowers you to insist that the client keep you informed throughout the bankruptcy case.

Contested Matters

Litigation requires expert use of evidence. This does not mean only abiding by evidentiary requirements; quickly gathering facts and carefully drafting pleadings is of utmost importance. What is more significant is that favorable rulings depend on the evidence you present, not on wishful thinking about what "justice" is. Banging on the table or making grand statements does not help the judge rule in your favor. Further, judges expect you to be familiar with the larger picture of the issue you are arguing. Contending that something is "black-letter law" when there is a circuit split on the issue is wasteful of your (and the court's) time and efforts. Remind yourself and your clients that we are a court. The judge must rule based on the facts presented.

When contested matters become contentious, you must plan on the possibility of appeal. A prepared and skillful attorney will help the bankruptcy judge help the attorney and their client. It is the attorney's job to give the bankruptcy judge the tools needed to explain his/her decision, including establishing a sufficient record of admissible evidence. The better and more robust the evidence, argument and reasoning, the better prepared any attorney will be for appeal. In addition to swaying the bankruptcy judge, it is essential to have a good basis on which to defend or ask for reversal at the appellate level.

Whether you are arguing for or against a motion, in addition to citing the law and rules, include the standard that must be met. Some lawyers like to say a decision is within the discretion of the judge. This by itself is insensitive to reversals and remands based on "abuse of discretion."[4] Judicial discretion does not stand alone; it must be considered in accordance with the principles of law and the standard mandated to meet the burden of proof for the relief requested.[5]

It is wise to become familiar with the bankruptcy judge's rulings and expectations, no matter to what court the case has been assigned. Judges expect attorneys to lead with the strongest argument in their case. Actively emphasizing the most significant points helps to focus the judge's attention on the issues considered most noteworthy to the litigants.

Preparation for Trial

Discovery is imperative and should be a cooperative endeavor. Collecting and sharing information and documents (written and electronic, in a format with metadata included) is necessary for trial preparation and aids possible settlement. The key term

1 Bankruptcy Judge **Elizabeth Gunn**, Senior Law Clerk **Brenda Robie**, and Law Clerks Francis O'Rourke and Dorie Arthur were helpful with ideas and editing my ramblings! I thank them.

2 The thoughts herein are my own. Hopefully, these tips will benefit your practice in any bankruptcy court!

3 *Compare In re Royal Bistro*, 26 F.4th 326 (5th Cir. 2022), *with Precision Indus. v. Qualitech Steel SBQ LLC*, 327 F3d 537 (7th Cir. 2003), and *Pinnacle Rest. at Big Sky LLC v. CH SP Acquisitions (In re Spanish Peaks Holdings II LLC)*, 872 F.3d 892 (9th Cir. 2017) (Fifth Circuit opined § 363(f) free-and-clear standard cannot force tenant out who is complying with lease obligations under § 365(h) unlike in Seventh and Ninth Circuits).

4 *Gen. Electric v. Joiner*, 522 U.S. 136 (1997).

5 *McHale v. Boulder Capital LLC (In re 1031 Tax Grp. LLC)*, 439 B.R. 84 (Bankr. S.D.N.Y. 2010) (explaining that although prejudgment interest is within court's discretion, court must explain and articulate its reasoning).

here is *cooperative*; rarely does a judge relish a discovery dispute. It is my expectation that those who appear in my court are professionals and must act as such.

In contested matters and adversary proceedings, simply follow the Federal Rules of Civil Procedure. It is good practice to be familiar with all rules of procedure, but a wise and prepared attorney will also read the Advisory Committee notes to each rule. For example, I should not have to remind attorneys of the requirements of Rule 26. It is often forgotten that Rule 26 outlines the *duty* to complete important initial disclosures without a formal request.[6] Inform the client(s) of their duty to you and that compliance is mandated by the Federal Rules.

If negotiations and mediations do not result in an agreement, all the work up to that point is important, and your "file" will be ready to compose the final pre-trial order and present it to the court at a conference. The pretrial is the court's "playbill." Careful thought is essential for a workable trial. The judge will prepare for the trial based on the order and will follow the course of actions as set out in the order. The pretrial outlines both sides of the case, what evidence will be presented, names of witnesses to be called and what their testimony will encompass. Seldom do "gotcha" moments occur during testimony — and never is testimony as shocking as on "Law and Order."

During Trial

Practice points in preparation for and carrying out the course of the trial is dependent on the attorney, who is charged with creating clarity at trial.[7] The attorney's responsibility to the client is to know the facts, law and standards required to prevail in the litigation. Remember trial practice in law school? Your representation of the facts must be achieved using the basic rules of courtroom advocacy.

For example, lawyers don't seem to know how to trust their own witnesses on direct examination. If you don't trust your witness, you have not prepared them sufficiently. The witness should be prepared to be the center of attention and answer questions in an unfamiliar setting. Being asked questions on direct can confuse even an experienced witness. No matter how many times a witness has testified, they need to be reminded about what they are being asked for and why it is important before they get on the stand.

This also applies to expert witnesses. Don't assume that a judge will neglect their role as gatekeeper. Written expert testimony should be presented along with the witness's *curriculum vitae*. Prior to trial, if there is opposition to the witness, a party can request the court to *voir dire* the testimony and the credentials of the expert.[8] Be prepared to meet the *Daubert* standard[9] — and know what is necessary for admission of expert testimony in a federal court.

Lawyers tend to try to ask leading questions on direct. Remember that it is the witness's story, not yours. Your expertise is necessary in helping the witnesses prepare and tell their story with credibility. Preparation of a witness is not to memorize a script or use legal language. Preparation is to refresh your client's memory with the facts, to guide them in describing the who, what, where, how and why, and to focus on the essential elements to make their case.

On the other side of the coin, many lawyers forget that leading questions are acceptable during cross-examination. Leading questions should be short and to the point of the case. The judge is watching and waiting for your or the cross-examiner's question, and it is possible that the judge has already spotted a hole in the direct testimony but needs help via questions that address the credibility of the witness and make a record for the opinion.

Cross-examination is not a game of retaliation; its purpose is to make sure the witness's testimony comports with sworn statements and the pleadings. Cross-examination begins with being familiar with the disposition testimony and listening carefully to the direct testimony for any inconsistencies. The first question to remember should be, "Does the courtroom testimony support or contradict the disposition testimony of the witness?"

While the dramatics of Hollywood may have inspired you to become a lawyer, this is not a television show. There is no reason to be hostile to the witness. The purpose of the trial is to sway the judge, not to demean or berate a witness. The cross-examination should allow the questioning attorney to show the judge the problems with the witness's testimony.

By and large, expert witnesses aside, the most common objections to examination questions are relevance and hearsay. All objections must be based on the Rules of Evidence. Know those objections and the exclusions. When standing to objection, give the judge the basis for the objection. Once, an attorney made as an objection, "I don't like what the witness is saying!" This is obviously not sufficient and damages your credibility.

Trials may sometimes be the continuation of stalemated negotiations between parties. Other times, they are the result of competent attorneys not being able to bring the parties to settlement. Trials can occur because the parties dislike each other, feel aggrieved, "want their day in court," or there is truly a question of fact or law that only a judge may decide. Keep in mind what the parties' reasons are for having the trial.

Whatever the reason for the trial, the judge often requires assistance with making the correct determination when issuing a written ruling by requesting post-trial briefs. To be effective, a good post-trial brief requires a succinct, clearly written memo presenting the law and evidence. Detailing the trial record by the page and line of the transcript is crucial, along with reference to the evidence introduced at trial, using the exhibit number and citing the relevant page(s). You want to point out what was said and why the witness testimony either boosts your client's position or is detrimental to the opposition's. They are a powerful tool for the lawyer to make their final argument to the judge before a decision is issued. It is wise to ask whether you can file a post-trial brief at the close of evidence regardless of the judge's intention to ask for one.

My colleagues throughout the nation could add to these main points, but these are the pet peeves I've garnered throughout my service on the bench. I am confident that following these simple "helpful hints" will make the judge's work more effective. abi

6 Fed. R. Civ. P. 26.
7 *See* Walter W. Bates, R. Todd Huntley & William S. Starnes, Jr., "Ten Tips for Direct Examination and Cross-Examination," *Am. J. Trial Advoc.* (2015).
8 Fed. R. Evid. 702, 703, 704, 705.
9 *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).

Nonconsensual Third-Party Releases and Legislative Efforts to Limit Them

Committee: Commercial and Regulatory Law

Gina M. Young

Dentons; Louisville, Ky.

Date Created: Wed, 2022-04-13 16:26

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Nonconsensual third-party releases in bankruptcy are the hot topic of debate recently. Even though there is no provision of the Bankruptcy Code that expressly authorizes these releases, no Code provision prohibits them, either. Therefore (drumroll), different circuits have different views on third-party releases, and because Congress is not always hot and heavy on the Bankruptcy Code, these splits tend to slowly get worked out in the appellate court process. But in what seems to be a reaction to some high-profile cases, some legislators have made efforts to ban nonconsensual third-party releases.

Circuit Split and Recent High-Profile Cases Involving Third-Party Releases

Not surprisingly, the circuit courts disagree on whether a bankruptcy court has the authority to approve a chapter 11 plan that releases nondebtors from liability without the consent of all parties in interest. The Fifth, Ninth and Tenth Circuits hold the minority view that bans nonconsensual releases as being prohibited by § 524(e) of the Bankruptcy Code, which provides generally that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

The Second, Fourth, Sixth, Seventh and Eleventh Circuits hold the majority view that such releases and injunctions are permissible under certain circumstances, relying on § 105(a) of the Bankruptcy Code, which authorizes a court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." The First and D.C. Circuits have suggested that they agree with the "pro-release" majority, and the Third Circuit declined to decide the issue in *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000).

Nonconsensual third-party releases are extensively used in chapter 11 and are necessary to resolve mass tort cases, like the clergy abuse cases, *In re USA Gymnastics* [1] and *In re Purdue Pharma LP*, [2] involving the opioid crisis. Use of these releases has been controversial, especially with respect to the release provided in a confirmed plan to the Sackler family in *Purdue Pharma* in exchange for what was seen as a nominal payment to the debtors' alleged opioid abuse victims over a 10-year period. Moreover, the release in this case was to be imposed on consenting and nonconsenting claimants. While the Sackler release saga continues to play out in the appellate process, the media coverage of these releases painted the process as an opportunity for billionaires to obtain lifetime immunity for engaging in deceptive practices that contributed to a national epidemic.

Proposed § 113 to the Bankruptcy Code

The *Purdue Pharma* plan sparked public debate over the use of chapter 11 to shield nondebtor parties as part of a plan. As a result, representatives in both the U.S. House and Senate introduced identically titled bills — H.R.4777 and S.2497 — the "Nondebtor Release Prohibition Act of 2021," in an attempt to limit nonconsensual third-party releases.

The bills propose to add a new § 113 to the Bankruptcy Code. In summary, subsection (a) of § 113 would prevent a bankruptcy court from approving any plan provisions that would discharge, release or modify the liability of a nondebtor or the bankruptcy estate. Further, a

court may not enjoin the commencement or continuation of any other proceeding to enforce the claim or cause of action, except for a short-term stay.

Subsection (b) of proposed § 113 provides that notwithstanding the prohibition of subsection (a), the prohibition does not prevent a court from authorizing a sale, transfer or other disposition of property free and clear of claims or interests; the court may continue to prevent third parties from exercising control over a right or interest that is property of the estate; and the prohibition is not a bar against any claim for indemnity, reimbursement or contribution that a nondebtor entity has against a third party once it has been released by the debtor or the estate.

Finally, the proposed prohibition does not apply to court approval of a plan providing for the release of a nondebtor in circumstances where clear and conspicuous consent to the release is given by each creditor. However, that consent must be individually given and cannot be inferred to be given by acceptance or failing to accept or reject a proposed plan. Moreover, the treatment of similar creditors cannot be different by reason of such entity's consent or failure to consent.

Practical Implications of Proposed § 113

At first glance, the bills appear to be narrowly targeted to prohibit use of releases in mass tort cases, and they have already garnered criticism of their impracticalness in these types of cases, where it will be virtually impossible to solicit the consent contemplated from each claimant. However, if enacted, the bills could also prevent the use of such releases in ordinary commercial cases, except those with only a small number of unsecured creditors. As a result, it will be difficult to generate any recovery for smaller creditors. Without the ability to include creditor releases, nondebtor third parties and their insurers will have no incentive to contribute to creditor recovery.

Moreover, the bills likely increase the chances of the liquidation or sale of assets, rather than use of a chapter 11 plan to reorganize because the reorganization process cannot be used to fully implement a collective solution.

Conclusion

As of this writing, the bills are both sitting in committee. S.2497 was referred to the Committee on the Judiciary on July 28, 2021 — the day the bills were introduced — and no

further action has been taken. H.R.4777 has surprisingly seen a little more traction. On Nov. 3, 2021, the House Committee on the Judiciary held a hearing and mark-up session, after which an amended version was sent to the House as a whole for consideration after a 23-17 vote in committee.

With these considerations in mind and the mounting concerns regarding the application of the proposed section, it is hard to imagine that the bills will be passed and enacted without significant revisions.

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[1] Case No. 2018-bk-09108, Doc. No. 1776 (Bankr. S.D. Ind.).

[2] 635 B.R. 26 (S.D.N.Y 2021).

Faculty

Deborah R. Chandler is the president of Anderson & Karrenberg in Salt Lake City, a diverse commercial and civil litigation practice. Since 2008, she has successfully represented individuals and companies in various complex matters, including commercial bankruptcy, contract interpretation, fraud, intellectual property, trademark infringement, employee covenants, securities, and real estate matters, shareholder/member disputes and guardianship proceedings. More recently, Ms. Chandler has represented court-appointed receivers charged with overseeing commercial receivership estates. She also has tort-litigation experience, both in district court and arbitration proceedings, defending care center facilities against wrongful death claims, and providing general insurance defense regarding automobile and premises liability. Ms. Chandler is listed among *Utah Business Magazine*'s Utah Legal Elite: Up and Coming™ (2014) and Utah Legal Elite™ (2017-21). She received her B.S. *cum laude* in marketing and finance from the University of Utah in 2004 and her J.D. in 2008 from the University of Utah S.J. Quinney College of Law, where she received the CALI Award for highest grade in intellectual property and the College of Law Award for second-highest grade in corporate finance.

Hon. Daniel P. Collins is a U.S. Bankruptcy Judge for the District of Arizona in Phoenix, appointed on Jan. 18, 2013. He served as chief judge from 2014-18 and is presently a conflicts judge in the Districts of Guam, Hawaii and Southern California. Previously, Judge Collins was a shareholder with the Collins, May, Potenza, Baran & Gillespie, P.C. in Phoenix, practicing primarily in the areas of bankruptcy, commercial litigation and commercial transactions. He is president of the National Conference of Bankruptcy Judges, is a Fellow in the American College of Bankruptcy, served on ABI's Board of Directors, is on the board of the Phoenix Chapter of the Federal Bar Association and is a member of the University of Arizona Law School's Board of Visitors. He also is a founding member of the Arizona Bankruptcy American Inn of Court. Judge Collins received both his B.S. in finance and accounting in 1980 and his J.D. in 1983 from the University of Arizona.

Hon. Terrence L. Michael is Chief Judge for the U.S. Bankruptcy Court for the Northern District of Oklahoma in Tulsa and a member of the Bankruptcy Appellate Panel of the Tenth Circuit. He has authored more than 170 published opinions, as well as articles in the *Tulsa Law Review*, *Texas Tech Law Review* and *Creighton Law Review*. Upon graduation from law school, Judge Michael joined the firm of Baird, Holm, McEachen, Pedersen, Hamann & Strasheim in Omaha, Neb., where he was a member of the firm's bankruptcy and creditors' rights practice group. His practice included all types of bankruptcy matters and general civil litigation. While at Baird, Holm, Judge Michael chaired the Bankruptcy Section of the Nebraska State Bar Association and was a member of the local rules committee responsible for drafting local rules in chapter 12 cases. He also authored and presented numerous papers at various continuing legal education seminars. Judge Michael has taught courses for the American Banker's Association School of Agri-Finance and Metro Technical Community College. On June 9, 1997, he began his career as a bankruptcy judge, and on June 7, 2000, he was appointed to the Bankruptcy Appellate Panel of the Tenth Circuit, a position he still holds. As a member of the BAP, Judge Michael chaired the committee charged with revising the local rules of that court. He has authored more than 170 opinions, is an associate editor of the *American Bankruptcy Law Journal* and an adjunct professor of law at the University of Tulsa, and has served as a speaker at various

seminars presented by the Federal Judicial Center, the Eighth Circuit Judicial Conference, the Tenth Circuit Judicial Conference, ABI, the Nebraska State Bar Association, the Oklahoma Bar Association, the Tulsa County Bar Association, the West Texas Bar Association and the Southwest Regional Turnaround Management Association. Judge Michael is a member of the National Conference of Bankruptcy Judges, having served on various committees and the Board of Governors. He received the President's Award for Distinguished Service to the Conference in 2018. Judge Michael is an emeritus member of the Council Oak/Johnson-Sontag American Inn of Court, which awarded him the John A. Athens Leadership Award in 2004, and the Nebraska State Bar Association. He was part of a multi-state select choir, which sang in Carnegie Hall in 1999, and recorded his first studio album in collaboration with Oklahoma Music Hall of Fame member and Grammy winner David Teegarden in 2018. Judge Michael received his B.A. *magna cum laude* in history from Doane College in 1980 and his J.D. from the University of Southern California's Gould School of Law in 1983.

Hon. Cathleen D. Parker is Chief U.S. Bankruptcy Judge for the District of Wyoming in Cheyenne, appointed on June 2, 2015. Prior to her appointment, she was an attorney with the Wyoming Attorney General's Office for 16 years, where she primarily represented the Wyoming Departments of Revenue and Audit in front of administrative tribunals, the Wyoming State Courts and the Wyoming Supreme Court. At the time of her appointment, she was the supervisor of the Revenue Section of the Civil Division and was the head of the Attorney General's Bankruptcy Unit. Prior to joining the Office of the Attorney General, Judge Parker worked as an attorney in private practice in Colorado, handling both civil and criminal matters. She also sits on the Tenth Circuit Bankruptcy Appellate Panel. Judge Parker received her J.D. with honors from the University of Wyoming College of Law in 1998.

Hon. Michael E. Romero is a U.S. Bankruptcy Judge in the District of Colorado in Denver, initially appointed in 2003 and appointed Chief Judge from July 2014-June 2021. He is also Chief Judge of the Tenth Circuit Bankruptcy Appellate Panel. Since becoming a judge, Judge Romero has served on numerous committees and advisory groups for the Administrative Office of the U.S. Courts, is the past chair of the Bankruptcy Judges Advisory Group and has served as the sole bankruptcy court representative/observer to the Judicial Conference of the United States, the governing body for the federal judiciary. He is a past president of the National Conference of Bankruptcy Judges and actively participates in several of its committees. He also serves on the Executive Board of Our Courts, a joint activity between the Colorado Judicial Institute and the Colorado Bar Association that provides programs to further public understanding of the federal and state court systems. Judge Romero is a member of the Colorado Bar Association, ABI, the Historical Society of the Tenth Circuit and the Colorado Hispanic Bar Association. He received his undergraduate degree in economics and political science from Denver University in 1977 and his J.D. from the University of Michigan in 1980.

Hon. William T. Thurman is a U.S. Bankruptcy Judge for the District of Utah in Salt Lake City, appointed in 2001 and now on recall status, and served as its chief judge. He also is a member and former chief judge of the Tenth Circuit Bankruptcy Appellate Panel. Judge Thurman served as a member of the U.S. Judicial Conference's Code of Conduct Committee and as a member of Conference's Financial Disclosure Committee. He has been active in the National Conference of Bankruptcy Judges, having served on its board and chaired several of its committees. He also has been a frequent speaker for and member of other national and local organizations focusing on lawyer and judicial education and ethical conduct, and he is a Fellow with the American College of Bankruptcy. Prior

to his appointment, Judge Thurman was in private practice in Salt Lake City with McKay, Burton & Thurman for 27 years, where he focused on bankruptcy law and served as a panel chapter 7 trustee. He received both his B.A. and J.D. from the University of Utah.