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INTRODUCTION

On December 10, 1966, the first asbestos-related lawsuit was filed against eleven asbestos manufacturers, including Johns-Manville, Combustion Engineering, and Owens-Corning.[1] This

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Lawrence Fitzpatrick is a founder and executive director of the Center for Claims Resolution. He is also the sole trustee of the Fibreboard Settlement Trust and the Met-Coil Systems Corporation TCE PI Trust. He currently serves as the FCR in the following cases: (i) *In re* ACandS, Inc., 311 B.R. 36, 41 (Bankr. D. Del. 2004); (ii) *In re* Global Industrial Technologies, Inc., Case No. 02-21626 (Bankr. W.D. Pa. 2002); (iii) *In re* North American Refractories Co., Case No. 02-20198 (Bankr. W.D. Pa. 2002); and (iv) *In re* Pittsburgh Corning Corp., Case No. 00-22876 (Bankr. W.D. Pa. 2000).

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1. *See* Tomplait v. Combustion Eng'g, Inc., No. C.A. 5402 (E.D. Tex. 1967).

proved to be just the beginning of many lawsuits, the number of which dramatically increased into the 1990s.[2] Plaintiffs initially named as defendants companies that produced asbestos-containing products; employers responsible for injuries caused by exposure; and manufacturers, distributors, and installers of asbestos-containing products. As time progressed, lawsuits began to name companies without substantial involvement with asbestos-containing products, including suits by persons in non-traditional industries where plaintiffs did not typically handle asbestos or asbestos-containing products, but were nevertheless exposed to asbestos in the workplace.[3] Companies large and small faced crippling asbestos liabilities that threatened to disrupt business operations as plaintiffs obtained increasingly large judgments.[4] The treatment of asbestos claimants varied significantly depending on their respective position in the so-called "race to the courthouse." Earlier claimants would fare well, while later claimants, manifesting diseases decades in the future, were at risk of receiving nothing after the earlier asbestos claimants depleted the assets of the responsible party.[5]

As a result of overwhelming asbestos claims, numerous companies have filed for bankruptcy,[6] hoping to resolve their asbestos liabilities in an efficient and cost-effective manner. Bankruptcy courts have struggled to balance a company's need to permanently resolve future asbestos claims against the desire to provide each asbestos victim with adequate and just compensation.[7] The solution that arose from the bankruptcy case of Johns-Manville Corp., one of the

2. *See* Kane v. Johns-Manville Corp., 843 F.2d 636, 639 (2d Cir. 1988) ("By the early 1980's, Manville had been named in approximately 12,500 such suits brought on behalf of over 16,000 claimants. New suits were being filed at the rate of 425 per month."); *see also In re* UNR Indus., 725 F.2d 1111, 1113 (7th Cir. 1984) (noting that UNR was a defendant in over 17,000 asbestos suits and expected to be sued by anywhere from 30,000 to 120,000 new asbestos victims).

3. *See* STEPHEN J. CARROLL ET AL., ASBESTOS LITIGATION 76–77 (2005).

4. For example, Johns-Manville feared its potential liability would reach $2 billion. *See* Georgene Vairo, *Mass Torts Bankruptcies: The Who, The Why and The How*, 78 AM. BANKR. L.J. 93, 100 (2004).

5. Steven L. Schultz, In re Joint Eastern and Southern District Asbestos Litigation: Bankrupt and Backlogged—*A Proposal for the Use of Federal Common Law in Mass Tort Class Actions*, 58 BROOK. L. REV. 553, 562–63 (1992) ("In reality, . . . the pool of capital available to compensate present and future plaintiffs frequently turns out to be exhausted before they even get into the courthouse.").

6. Companies that wish to liquidate their assets and dissolve file bankruptcy under Chapter 7 of the Bankruptcy Code. 11 U.S.C. §§ 701–784 (2000). Companies that wish to reorganize and continue to operate file bankruptcy under Chapter 11 of the Bankruptcy Code. 11 U.S.C. §§ 1101–1174 (2000).

7. *See* Schultz, *supra* note 5, at 562 ("The fundamental debate that has raged over asbestos litigation is essentially one of idealism versus pragmatism. In a perfect world each and every asbestos victim would be entitled to his or her day in court and would receive full compensation for any injury.").

world's leading asbestos manufacturers,[8] has proven to be both innovative and influential.

In the Manville case, Judge Lifland issued an injunction, based on the court's equitable powers, that channeled Manville's asbestos liabilities related to personal injuries to a trust funded by certain of the company's assets.[9] Claims against Manville, no matter how far into the future, could be brought only against the trust established in 1984.[10] The Manville trust was funded not only by insurance settlements, cash, and receivables, but also by stock in the reorganized company and a right to receive future profits.[11] As a result, the future asbestos personal injury claimants (the "future claimants") in Manville benefited from the reorganization of the company and its continued operations,[12] likely more so than had the company simply liquidated because of the onslaught of lawsuits.[13]

8. *See id.* at 565 ("The central provision of the Plan was the establishment of two 'evergreen' trusts that would assume all the asbestos liabilities of the reorganized and renamed Manville Corporation.").

9. *In re* Johns-Manville Corp. (*Manville*), 68 B.R. 618, 624 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987) (*Manville II*), *aff'd sub nom.* Kane v. Johns-Manville Corp., 843 F.2d 636 (2d Cir. 1988). The Manville Plan also called for the creation of a property damage trust to be funded with $125 million and the right to receive insurance recoveries in excess of $615 million under certain insurance policies. *Id.* at 622.

10. *See id.*

11. *See* Vairo, *supra* note 4, at 101–02.

12. The average claim settlement amount from the trust in 2007 was $4,300, and the value of the trust's investments, as of March 31, 2007, was $1.813 billion. *See* Letter from Robert A. Falise, Chairman and Managing Tr., Manville Pers. Injury Settlement Trust, to Honorable Jack B. Weinstein, Senior Judge, E.D.N.Y, and Honorable Burton R. Lifland, Judge, Bankr. S.D.N.Y. (Apr. 30, 2007), *available at* http://www.mantrust.org/FILINGS/1stqtr07.pdf. As of March 31, 2007, the Manville Trust had received a total of 782,349 claims and made total payments of approximately $3.4 billion. *See id.*

13. Nothing in the Bankruptcy Code explicitly requires the appointment of a legal representative for future asbestos personal injury claimants where a debtor liquidates and dissolves (with no channeling injunction issued under § 524(g)) rather than reorganizing. *See* 11 U.S.C. § 524(g) (2000). As a result, future claimants face the possibility that they will recover nothing in a liquidation.

In *Manville*, the large number of claimants against the trust resulted in the depletion of the trust. *See* Vairo, *supra* note 4, at 104. Even though the challenging injunction was based on the initial assumption that the trust would pay 100% of liquidated value of claims, the *Manville II* court did not find that the switch to trust payments based on the payment percent justified the need to reevaluate the channeling injunction. *See id.* at 104–05.

Finding the channeling injunction and trust structure in *Manville* to be a possible solution to the growing number of asbestos lawsuits, Congress added § 524(g) to the Bankruptcy Code in 1994, explicitly authorizing the issuance of channeling injunctions for asbestos trusts (the "Manville Amendments").[14] Modeled after the *Manville* bankruptcy case, the Manville Amendments codified a procedure for reorganizing companies facing potentially crippling future personal injury claims.[15] Asbestos liability has forced at least seventy-four companies into bankruptcy, forty-four after the Manville Amendments.[16] The vast majority of these cases, including *In re Federal Mogul, In re Owens Corning, In re Babcock & Wilcox, In re W.R. Grace,* and *In re Armstrong* have utilized conventional[17] Chapter 11 proceedings (as opposed to prepackaged reorganization plans) to resolve their present and future asbestos liabilities.[18] Unfortunately, conventional asbestos bankruptcies have proven to be slow—averaging around five to six years—and very expensive.[19]

14. *See* § 524(g)(1)(B) (authorizing a court to "enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust . . . except such legal actions as are expressly allowed by the injunction, the confirmation order, or the plan of reorganization.").

15. *See* 140 CONG. REC. 27,699 (1994) (statement of Rep. Fish) (stating that the purpose of § 524(g) is to "clarify judicial authority to issue injunctions in certain circumstances where trusts are created to pay asbestos related claims—because we recognize that by removing uncertainty over the validity of such injunctions, the value of trust assets available to fund recoveries by victims can increase.").

16. *See, e.g.*, Patrick M. Hanlon & Anne Smetak, *Asbestos Changes*, 62 N.Y.U. ANN. SURV. AM. L. 526, 556 (2006) ("The sudden collapse of Owens Corning caused a sharp reaction on Wall Street that made capital impossible to come by for what were now seen as 'asbestos-tainted' companies. This reaction, in turn, pushed other companies over the edge. Armstrong World Industries filed for bankruptcy protection in December 2000, followed in 2001 by G-I Holdings (GAF), USG, W.R. Grace, Federal Mogul (Turner & Newall) and a number of less prominent companies."); *see also* Asbestos Alliance, Asbestos Bankruptcies, http://www.asbestossolution.org/bankruptcies.doc (last visited Jan. 23, 2008).

17. *See infra* note 20 (defining "conventional" and "prepackaged" bankruptcies).

18. *See In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005); *In re* W.R. Grace & Co., 366 B.R. 302 (Bankr. D. Del. 2007); *In re* Federal-Mogul Global, Inc., 330 B.R. 133, 136 (Bankr. D. Del. 2005); *In re* Armstrong World Indus., 320 B.R. 523, 524 (Bankr. D. Del. 2005); *In re* Babcock & Wilcox Co., 274 B.R. 230, 233 (Bankr. E.D. La. 2002).

19. *See In re* Kaiser Aluminum Corp, 456 F.3d 328, 331 (3d Cir. 2006) (four years); *In re* Owens Corning, 419 F.3d at 201–02 (six years); *In re* Armstrong World Indus., 320 B.R. at 527 (six years); *In re* USG Corp., No. 01-2094, 2003 WL 845571, at *1 (Bankr. D. Del. Feb. 19, 2003) (five years); *In re* Babcock & Wilcox Co., 274 B.R. at 234 (six years); *In re* Johns-Manville Corp., 66 B.R. 517, 520 (Bankr. S.D.N.Y. 1986) (four years).

In contrast, prepackaged asbestos cases (hereinafter "prepacks")[20] have the potential to obtain bankruptcy court approval and conclude relatively quickly (once filed) as the parties negotiate a reorganization plan, draft plan documents, and solicit creditor approval before filing the case.[21] As a result, the parties are often able to confirm their plan within one year, if not within a few months, of filing for bankruptcy.[22] For example, Fuller-Austin, the first asbestos prepack, confirmed a plan just over two months after the initial bankruptcy filing and within a year of commencing negotiations.[23] Since then, several companies, including Halliburton and J.T. Thorpe Co., have successfully implemented their own prepacks.[24]

Timing is a key issue with any asbestos bankruptcy, particularly with a prepackaged asbestos bankruptcy. As claimants begin obtaining judgments against and settlements with a company, the company's assets and operations (and hence, value) can deteriorate

20. Prepacks are distinguished from what will be referred to herein as "conventional" asbestos bankruptcies in that prepack reorganization plans are negotiated and creditors are solicited—given the opportunity to accept or reject the plan—all before the prepack is filed. After the case is filed, the bankruptcy court holds a joint hearing concerning the disclosure statement and reorganization plan. *See* FED. R. BANKR. P. 3002(b)(2). In conventional asbestos bankruptcies, the plan negotiations, solicitation of creditor approval, separate disclosure statement, and confirmation hearings all take place post-petition, resulting in a slower, more expensive process.

21. *See* Vairo, *supra* note 4, at 107.

22. *See, e.g.*, Susan Power Johnston & Katherine Porter, *Extension of Section 524(g) of the Bankruptcy Code to Nondebtor Parents, Affiliates, and Transaction Parties*, 59 BUS. LAW. 503, 526 (2004) ("[I]t seems likely that the only expeditious way for a corporate parent or successor to pursue § 524(g) relief is to organize a prepackaged bankruptcy filing, wherein the plan of [reorganization] already has the consent of the necessary parties.").

23. Fuller-Austin's petition was filed on September 4, 1998, and its plan was approved on November 13, 1998. *See In re* Fuller-Austin Insulation Co., No. 98-2038, 1998 U.S. Dist. LEXIS 23567 (Bankr. D. Del. Nov. 13, 1998) (order approving the disclosure statement and confirming the plan of reorganization).

24. *See In re* A.P.I., Inc., 331 B.R. 828, 869-70 (Bankr. D. Minn. 2005); *In re* Mid-Valley, Inc., 305 B.R. 425, 426 (Bankr. W.D. Pa. 2004); *In re* ACP Holding Co., No. 03-12414 (Bankr. D. Del. Sept. 25, 2003) (order confirming amended prepackaged joint plan of reorganization of ACP Holding Co., NFC Castings, Inc., Neenah Foundry Co. and certain of its subsidiaries under Chapter 11 of the bankruptcy code); *In re* J T Thorpe Co., 308 B.R. 782, 792–93 (Bankr. S.D. Tex. 2003); *In re* Shook & Fletcher Insulation Co., No. 02-02771 (Bankr. N.D. Ala. Oct. 29, 2002) (order confirming Shook & Fletcher Insulation Co.'s second amended plan of reorganization); *Fuller-Austin*, No. 98-2038, 1998 U.S. Dist. LEXIS 23567, at *68.

quickly.[25] A prepackaged plan of reorganization may not be a viable alternative for a company that waits too long to pursue a bankruptcy filing—until after asbestos litigation has consumed much of the company's insurance and after the pressure of that litigation has undermined the company's operations and, potentially, the company's access to the capital market.[26] A company with an urgent need to file for bankruptcy typically is not an ideal candidate for a prepackaged plan. A prepack usually involves lengthy pre-bankruptcy negotiations among many parties, including the company, claimants, insurers, the FCR, and other interested parties. In short, a prepack candidate must have the business strength to survive in both the marketplace and the tort system while the pre-bankruptcy negotiations unfold.

While companies can obtain the unique protection provided via a § 524(g) injunction only through the bankruptcy process (whether through a conventional or prepackaged bankruptcy), pursuing such an injunction through a prepackaged bankruptcy offers several distinct advantages when compared to the more conventional "free fall" bankruptcy process. Most significantly from the perspective of the prospective debtor, a prepackaged case ensures that the company will have a greater ability to shape the outcome of its reorganization than it would in a conventional case. As discussed below, in a conventional case there exists a risk that the court will approve a plan of reorganization proposed by a party

25. *See* Affidavit of James E. Hipolit in Support of First Day Motions at ¶¶ 16, 22–26, *In re* ACandS, Inc., No. 02-12687 (Bankr. D. Del. Sept. 16, 2002) (describing the negative effect on the company caused by adverse judgments and refusals of insurance coverage).

26. In the bankruptcy case of *In re* Mid-Valley, Inc. described in Part V *infra*, the company's access to credit was significantly impaired after several adverse asbestos judgments:

> The verdicts/judgments also adversely affected the status of Halliburton's public debt. Late in 2001 and early in 2002, certain agencies lowered their ratings of Halliburton's long-term senior unsecured debt. According to the rating agencies, these ratings were lowered primarily due to concerns about the asbestos and silica liabilities of Halliburton and its affiliates. The agencies indicated that, absent a global settlement of asbestos claims, Halliburton's ratings would continue to be under consideration for possible downgrades. With each downgrade, the cost of new borrowing became higher and the company's access to the debt and financial markets became more restricted.

Findings of Fact & Conclusions of Law Regarding (I) Debtors' Disclosure Statement & Solicitation Procedures, & (II) Confirmation of Debtors' Fourth Amended & Restated Joint Prepackaged Plan of Reorganization under Chapter 11 of the United States Bankruptcy Code at 10-11, *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. July 16, 2004) [hereinafter *Mid-Valley Findings*].

other than the debtor.[27] A prepack also drastically shortens the time that a company stays "inside" of bankruptcy and thus subject to bankruptcy court oversight, increased business disruptions, attendant negative publicly, and administrative burdens and expenses. In addition, when a company negotiates a plan of reorganization before filing for bankruptcy, it can use the anticipation of a bankruptcy filing as leverage to negotiate favorable terms from its creditors. Thus, prepacks can be quite effective in minimizing the negative operational and market impacts and administrative costs that often accompany conventional asbestos bankruptcies.[28] Nevertheless, as discussed below, the decision to pursue a prepack requires a thoughtful, fact-intensive decision on the part of the prospective debtor as prepacks take longer to prepare before filing than conventional bankruptcies. During this time, the company must continue to defend and pay asbestos claims within the tort system, the costs of which the company must weigh against the benefits of a prepack.

Because minimizing the negative impacts and expenses accompanying a conventional bankruptcy filing also benefits future claimants, it should come as no surprise that FCRs often support prepackaged bankruptcies for many of the same reasons that debtors pursue them. From the perspective of future claimants, a prepack can often help preserve the value of the estate through a shorter stay in bankruptcy and reduction of business disruption and other costs related to the bankruptcy proceedings. On the other hand, just as prepacks are not costless options to a debtor/defendant, they may not be costless options to the future claimants either. For example, a risk created by prepacks is that by taking the time to negotiate a prepack outside of bankruptcy, the company (and indirectly, the future claimants) may be adversely affected by asbestos litigation that would have otherwise been halted by an au-

27. *See infra* Part III.A (describing the possibility of a debtor's losing control of the reorganization process after the exclusivity period terminates).

The exclusivity period is the first 120 days after entry of the order for relief, in which time the debtor is the sole party permitted to file a plan of reorganization. *See* 11 U.S.C. § 1121(b) (2000). The court may extend the exclusivity period, but not for longer than eighteen months after entry of the order for relief. *See* § 1121(d).

28. John D. Ayer, Michael L. Bernstein & Jonathan Friedland, *Out-of-Court Workouts, Prepacks and Pre-Arranged Cases: A Primer*, 24-3 ABIJ 16 (2005) ("'Pre-packaging' a chapter 11 reorganization enables a debtor to minimize the impact to its ongoing business operations by combining many of the best aspects of out-of-court workouts—cost-efficiency, speed, flexibility and cooperation—with the binding effect and structure of a conventional bankruptcy.").

tomatic stay had the company simply filed for a conventional bankruptcy case.[29]

In recent years, several prepacks have encountered substantial difficulties throughout the reorganization process, resulting in a longer and more costly plan-confirmation process.[30] For instance, in *In re Combustion Engineering, Inc.*, the parties were forced to negotiate a new reorganization plan after the Third Circuit vacated the confirmation of the prepack plan.[31] In *In re Congoleum Corp.*, the Third Circuit overturned the retention of the debtor's special insurance counsel because of a conflict of interest,[32] and the parties have yet to confirm a reorganization plan after ten previously filed plans

Because of such difficulties, certain commentators have suggested that prepacks undermine the protections that § 524(g) is intended to provide for future claimants in the bankruptcy context.[33] These commentators argue that a company's prepetition selection of the legal representative for future claimants (the "future claimant representative" or "FCR")[34] taints the prepack process and fails

29. *See* 11 U.S.C. § 362(a) (2000). The automatic stay of the Bankruptcy Code causes all litigation against the debtor to cease upon the mere act of filing a bankruptcy petition, unless the litigation falls within an exception to the automatic stay. Once litigation is stayed, however, an opposing party can move the bankruptcy court for relief from the automatic stay to pursue the litigation in either a bankruptcy or non-bankruptcy forum. *See* § 362(d).

30. *See generally In re* Congoleum Corp., Case No. 03-51524 (Bankr. D.N.J. 2003) (representing an attempted prepack later filed as a conventional bankruptcy case); *see also In re* Quigley Co., 377 B.R. 110, 115 (Bankr. S.D. N.Y. 2007); *In re* ABB Lummus Global Inc., No. 06-10401, 2006 WL 2052409 (Bankr. D. Del. June 29, 2006); *In re* ACandS, Inc., 311 B.R. 36, 37–39 (Bankr. D. Del. 2004) (partially negotiated prepetition, but eventually filed as a conventional bankruptcy case); Pre-Petition Comm. of Select Asbestos Claimants v. Combustion Eng'g, Inc. (*In re* Combustion Engineering, Inc.), 292 B.R. 515, 517 (Bankr. D. Del. 2003).

31. *See* 391 F.3d 190, 248–49 (3d Cir. 2004) (vacating the plan).

32. *See* Century Indem. Co. v. Congoleum Corp. (*In re* Congoleum Corp.), 426 F.3d 675, 681 (3d Cir. 2005) (reversing the order of the bankruptcy court approving the retention of the debtor's special insurance counsel post-petition).

33. *See* Mark D. Plevin et al., *The Future Claims Representative in Prepackaged Asbestos Bankruptcies: Conflicts of Interest, Strange Alliances, and Unfamiliar Duties for Burdened Bankruptcy Courts*, 62 N.Y.U. ANN. SURV. AM. L. 271, 273 (2006) ("As morphed to fit into the paradigm of a 'prepackaged' bankruptcy, the FCR lacks the independence that Congress plainly envisioned for that key player in the § 524(g) bankruptcy process.").

34. Appointment of an FCR is required under 11 U.S.C. § 524(g)(4)(B)(i) (2000). The court appoints an FCR to represent the interests of claimants whose interests might be affected in the future by the issuance of a channeling injunction.

to live up to the standard for an FCR contemplated by Congress in § 524.[35]

Contrary to the criticism of such commentators, and despite the potential risks created by a delay in filing for bankruptcy, well-structured prepackaged asbestos bankruptcies can be confirmed quickly and in a cost-effective manner. Prepacks can also offer the appropriate candidates for bankruptcy more negotiating flexibility and less risk as compared to a conventional bankruptcy. Moreover, asbestos prepacks are fully consistent with the goals of § 524(g) and the fiduciary duties and obligations undertaken by an FCR. An FCR's chief motivation for supporting a prepackaged asbestos bankruptcy process in lieu of a conventional bankruptcy in a specific case would be that the FCR believes that a prepack will be most advantageous to the future claimants. By reducing the disruptive impacts and expenses of a conventional bankruptcy filing, the FCR is in a better position to obtain the most favorable settlement possible for future claimants.[36]

The remainder of this Article will further explain why prepacks have been, and still remain, a valuable option for companies saddled with large asbestos liabilities. Prepacks allow companies to stay under bankruptcy court supervision for less time and with fewer bankruptcy-related costs and risks. One of the most important ways to ensure that a prepack will be successful is to involve an FCR early in the negotiations leading to a prepackaged bankruptcy case.

Part I of this Article addresses the role of the FCR in both conventional and prepackaged asbestos bankruptcies and shows how the appointment of an experienced FCR can benefit future claimants. Part II examines the reasons why the support of the FCR in prepackaged asbestos bankruptcies is consistent with the fiduciary duties undertaken by the FCR. Part III analyzes numerous factors that influence a company's prepetition selection of an FCR and argues that tremendous market pressure on a company provides discipline in making that decision. Part IV illustrates some common pitfalls into which recent prepacks have fallen, such as conflicts of

35. *See* Plevin et al., *supra* note 33, at 292 ("The prospective debtor and current claimants select and hire a pseudo FCR purportedly to engage in the pre-bankruptcy negotiations on behalf of the future claimants. In choosing this pseudo FCR, prospective debtors and current claimants are unlikely to choose the most formidable adversary against whom to negotiate. Instead, they are likely to seek someone more pliant and cooperative.").

36. As is explained in greater detail in Part II *infra*, both an FCR and a debtor have an interest in minimizing professional fees—both in and outside of bankruptcy. As such, debtors have commonly filed prepackaged reorganization plans to minimize the expenses associated with resolving asbestos claims.

interest, depletion of funds prior to filing, two-trust structures, and pre-petition settlements with current claimants. Avoiding these pitfalls can help ensure a timely and cost effective reorganization. Part V summarizes and analyzes the confirmation of the Halliburton prepack as a potential model for future prepacks.

I. OVERVIEW OF THE ROLE OF THE FUTURE CLAIMANT REPRESENTATIVE

A. *Role of the Future Claimant Representative in Asbestos Bankruptcy Cases*

In a bankruptcy case, the FCR represents the interests of future claimants who have been exposed to asbestos but have not yet brought claims against the debtor/defendant.[37] Because of the long latency period common to many asbestos-related diseases, individuals may not manifest any symptoms of an asbestos-related disease for many years, possibly decades, after an initial asbestos exposure.[38] As a result, a debtor's asbestos liabilities consist of claims by both current asbestos claimants and the future claimants who will later manifest asbestos-related illnesses.[39] Because the identities of future claimants cannot be known at the time of a debtor's bankruptcy, they cannot be individually afforded the notice required by the Due Process Clause of the Fourteenth Amendment.[40] In order to protect the rights of the future claimants,

37. *See* Yair Listokin & Kenneth Ayotte, *Protecting Future Claimants in Mass Tort Bankruptcies*, 98 NW. U. L. REV. 1435, 1443 (2004) (discussing the purposes and goals sought to be achieved by appointing an FCR to represent future claimants in mass tort cases).

38. *See* Frederick Tung, *The Future Claims Representative in Mass Tort Bankruptcy: A Preliminary Inquiry*, 3 CHAP. L. REV. 43, 51 (2000) ("The latency period for asbestos-related disease, for example, may run as long as forty years.").

39. *See id.* ("[T]he liability will not all mature at once, but progressively over time. In addition, the severity of the individual harms that ultimately manifest will vary depending on individual circumstances. While it is impossible to pinpoint how much time or how much liability, it becomes clear at a certain point that the aggregate liability eventually will be staggering, and the manufacturer's survival will be in doubt.").

40. *See* Todd W. Latz, Note, *Who Can Tell the Futures? Protecting Settlement Class Action Members Without Notice*, 85 VA. L. REV. 531, 557–58 (1999) (noting the inherent difficulties in providing notice to future claimants when they themselves may not realize that they will have a future claim); *see also* Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 317–18 (1950) ("We recognize the practical difficulties and costs that would be attendant on frequent investigations into the status of great numbers of beneficiaries, many of whose interests in the common fund

nearly every bankruptcy court before the Manville Amendments appointed FCRs on behalf of the future claimants in asbestos bankruptcy cases.[41]

In light of the overriding interest of future claimants in preserving the value available to satisfy their claims, an FCR obviously has a keen interest in the value of a debtor's estate because it will largely determine the FCR's ability to obtain an appropriate settlement on behalf of the future claimants.[42] As will be discussed below, even though the interests of future claimants are adverse to a company when it comes to the issue of how much a company must pay to satisfy their claims (funding a § 524(g) trust), their interests are often aligned when it comes to managing the bankruptcy case in a manner that best preserves the company's going-concern value. This is particularly true as most § 524(g) trusts are funded by stock in the reorganized debtor.[43] Once an FCR comes to an agreement with a company and current claimants, the FCR obviously wants the resolution embodied in their joint plan of reorganization to be confirmed. As such, there are many instances in bankruptcy proceedings in which the future claimants can actually *benefit* by cooperating with the company. This is an important but subtle distinction that has been missed by commentators that have examined the role of the FCR.

B. *Statutory Requirement of a Future Claimant Representative*

In § 524(g), Congress codified the requirement that an FCR be appointed for future claimants as a prerequisite for obtaining a channeling injunction.[44] By enacting the Manville Amendments,

are so remote as to be ephemeral; and we have no doubt that such impracticable and extended searches are not required in the name of due process.").

41. *See, e.g.*, *In re* Amatex Corp., 755 F.2d 1034, 1035 (3d Cir. 1985). *But see* Locks v. United States Tr., 157 B.R. 89, 96–97, 99 (Bankr. W.D. Pa. 1993) (declining to appoint an FCR because the appointment of an FCR was not required in a liquidation proceeding and it was within the discretion of the bankruptcy court to determine that in a liquidation, the time had come to cut off future claims, distribute the assets, and close the estate).

42. *See, e.g.*, Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999) ("[T]he two recognized policies underlying Chapter 11 [are] preserving going concerns and maximizing property available to satisfy creditors . . . ."). A prepack is consistent with the public policy rationales for Chapter 11 in that a prepack can be an effective tool to preserve the going-concern value of a debtor and to maximize the property available to creditors.

43. *See* 11 U.S.C. § 524(g)(2)(B)(i)(III) (2000).

44. *See* § 524(g)(4)(B)(i) ("[A]s part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such

Congress sought to ensure that future claimants would be adequately represented throughout reorganization proceedings. [45] Future claimants are entitled to representation independent of current claimants, as the two groups may have competing interests in respect to some of the issues that arise in the context of a § 524(g) bankruptcy case.[46] For example, even though the current and future claimants share the goal of full compensation for all injured claimants, the interests of future claimants in the long-term preservation of assets may be at odds with the current claimants' interests in maximizing immediate payouts.[47]

Section 524(g) provides that a court may permanently enjoin entities from taking legal action to pursue claims that are supposed

kind . . . ."). This statutory requirement for a future claimant representative was based upon the experience of cases like *Manville, UNR,* and *Amatex.* Additionally, "Congress specifically made the Manville Amendments retroactive in order to include *Manville* within their purview." Ralph R. Mabey & Peter A. Zisser, *Improving Treatment of Future Claims: The Unfinished Business Left by the Manville Amendments,* 69 AM. BANKR. L.J. 487, 497 n.49 (1995).

45. 140 CONG. REC. 27,692 (1994) (statement of Rep. Brooks) ("The Committee remains concerned that full consideration be accorded to the interests of future claimants, who, by definition, do not have their own voice."); *see also In re* Combustion Eng'g, Inc., 391 F. 3d 190, 234 n.45 ("Many of these requirements are specifically tailored to protect the due process rights of future claimants.").

46. In *In re* Amatex Corp., 755 F.2d at 1042–43, the Third Circuit noted that the interests of future claimants were often at odds with the interests of the current claimants and other creditor constituencies:

> We conclude that future claimants are sufficiently affected by the reorganization proceedings to require some voice in them. Moreover, none of the parties currently involved in the reorganization proceedings have interests similar to those of future claimants, and therefore future claimants require their own spokesperson.
>
> The Creditors' Committee, which is comprised of asbestos claimants whose injuries already have been manifested, has opposed the petition to appoint a representative for future claimants. Its position is that such claimants are not "creditors" under the Code and thus cannot participate in the reorganization. Of course, if future claimants are excluded from the reorganization plan, the current claimants will receive a larger portion of an obviously limited fund.

47. *See* Listokin & Ayotte, *supra* note 37, at 1438 ("Currently injured present claimants may have pressing liquidity needs (such as medical expenses) that demand immediate compensation."); Francis E. McGovern, *The Evolution of Asbestos Bankruptcy Trust Distribution Plans,* 62 N.Y.U. ANN. SURV. AM. L. 163, 164 (2006) ("The current claimants have an interest in maximizing immediate payments, whereas the future representative looks to conserve funds to ensure equivalent payments to an as of yet unknown, but projected, number of future claimants. Although the current and future claimants are allied in seeking the largest amount possible for all asbestos personal injury plaintiffs, they may have differences in how that amount should be divided.").

to be paid by a § 524(g) trust.[48] In essence, the injunction "channels" all of a debtor's asbestos liabilities to a trust. Before issuing a channeling injunction under § 524(g), the court must determine that the injunction is "fair and equitable" to the future claimants.[49] In making this determination, the court often relies heavily on the FCR's assessment regarding the fairness of the proposed channeling injunction and the adequacy of the funding of the trust.[50] It may be difficult, if not impossible, for a debtor to confirm a reorganization plan without the FCR's support.[51] Indeed, § 524(g) arguably confers upon the FCR the power to veto the issuance of a channeling injunction.[52]

48. *See* § 524(g)(1)(B) ("An injunction may be issued . . . to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust . . . .").

49. The injunction must be "fair and equitable with respect to the persons that might subsequently assert such demands, in light of the benefits provided, or to be provided, to such trust on behalf of such debtor or debtors or such third party." § 524(g)(4)(B)(ii).

50. *See, e.g.,* S. ELIZABETH GIBSON, FED. JUDICIAL CTR., JUDICIAL MANAGEMENT OF MASS TORT BANKRUPTCY CASES 68 (2005) ("Contrary to the practices called for by the National Bankruptcy Review Commission, future claims representative have not filed claims or voted on plans on behalf of the future claims they represent. Instead, their influence in the case has come through their persuasive abilities (both in court and in negotiations) and the likely concerns of other parties about the feasibility and legitimacy of confirming a plan to which the future claims representative objects.").

51. *See id.* ("There is evidence that this potential veto power, as well as the representative's advocacy in court, has resulted in the improved treatment of future claimants in some reorganization plans."). *See generally In re* Congoleum Corp., Case No. 03-51524, 2007 Bankr. LEXIS 1707 (Bankr. D.N.J. May 11, 2007). In *Congoleum,* the bankruptcy court rejected a proposed settlement between the debtors and Travelers Insurance. Under the proposed settlement, Travelers would have paid the debtors $25 million to buy back eighteen policies issued by Travelers. While the court rejected the FCR's allegations that the settlement was negotiated in bad faith, the court nonetheless found that the debtors failed to prove a sound business purpose. The case illustrates the reluctance of a bankruptcy court to approve a settlement, let alone a plan of reorganization, over the vigorous objection of an FCR.

52. Section 524(h) conditions the enforcement of injunctions issued before October 22, 1994, upon the non-objection of the legal representative in that case. *See* 11 U.S.C. § 524(h)(1)(C). Section 524(g) provides that a court must appoint a legal representative to protect the rights of future claimants and that the court must determine that any channeling injunction is "fair and equitable" to the future claimants. § 524(g)(4)(B). When read together, §§ 524(g) and (h) arguably condition the enforceability of a channeling injunction upon the consent of the FCR to the confirmation of a plan containing a channeling injunction. Absent the power to block the channeling injunction, the FCR would be assigned the constitutionally mandated task of protecting the due process rights of unknown future

Additionally, in order for the debtor to qualify for the protection of a channeling injunction, the debtor and the proposed trust must meet the statutory requirements of § 524(g).[53] For example, the trust must assume the debtor's asbestos liabilities for personal injury and wrongful death actions and then use its assets or income to pay the assumed liability.[54] The trust must also be funded by securities of the debtor and have at least a contingent right to own a majority of the voting shares of such debtor (or a parent or subsidiary).[55] Moreover, the trust must operate through certain mechanisms such as "periodic or supplemental payments, pro rata distributions, matrices," or periodic estimates of present claims and future demands.[56] These trust structures are intended to provide assurances to the future claimants that "the trust will value, and be in a financial position to pay, present claims and future demands

claimants, but would not possess any authority to accomplish the task. Indeed, if future claimants each had their own vote, no plan that imposed a channeling injunction could be approved in the face of their opposition. The magnitude of the interests of future claimants and the weight of the due process issues in asbestos bankruptcy cases weigh in favor of a broad construction of §524(g) to favor the rights of future claimants.

53. *See* § 524(g)(4)(B).

54. *See* § 524(g)(2)(B)(i)(I) (The trust must "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 allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products."); *see also* § 524(g)(2)(B)(i)(IV) (The trust "is to use its assets or income to pay claims and demands.").

55. *See* § 524(g)(2)(B)(i)(II) (The trust must "be funded in whole or in part by the securities of [one] or more debtors involved in such plan and by the obligation of such debtor or debtors to make future payments, including dividends."); §524(g)(2)(B)(i)(III) (The trust "is to own, or by the exercise of rights granted under such plan would be entitled to own if specified contingencies occur, a majority of the voting shares of—each such debtor; the parent corporation of each such debtor; or a subsidiary of each such debtor that is also a debtor.").

56. *See* § 524(g)(2)(B)(ii)(V) ("[T]he trust will operate through mechanisms such as structured, periodic, or supplemental payments, pro rata distributions, matrices, or periodic review of estimates of the numbers and values of present claims and future demands, or other comparable mechanisms, that provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner."). Generally a section 524(g) trust will review claims using evidentiary criteria that are at least as stringent as the settlement criteria historically applied by the debtor prior to its bankruptcy filing and as the criteria applied by other defendants in the tort system. *See* Findings of Fact and Conclusions of Law in Support of an Order Recommending Confirmation of the Joint Plan of Reorganization as of September 28, 2005 as Amended through December 22, 2005 at 33-34, 39, *In re* Babcock & Wilcox, Inc., No. 00-10793 (Bankr. E.D. La. December 28, 2005).

that involve similar claims in substantially the same manner."[57] Finally, in addition to the normal voting requirements needed to confirm a reorganization plan contained in § 1126(c), § 524(g) requires the favorable vote of seventy-five percent of the current claimants.[58]

C. *Appointment of Experienced FCRs*

The benefits of retaining an experienced FCR in an asbestos bankruptcy case cannot be overstated. Contrary to the assertions of some commentators,[59] the appointment of an FCR who is not a "repeat player" (i.e., experienced) in the field of asbestos bankruptcies may result in a less favorable outcome for future claimants.[60] In asbestos bankruptcies, the negotiations among the debtor, current claimants, and other liable third-parties often revolve around complex or otherwise "fine print" points of the reorganization plan: the structure and timing of the contributions made by the debtor and insurers, the scope of the channeling injunction, the insurance neutrality language in the plan of reorganization, and the trust distribution procedures and trust agreement for the § 524(g) trust. Because of the complex statutory requirements of § 524(g), much

57. § 524(g)(2)(B)(ii)(V).

58. *See* 11 U.S.C. § 1126(c) (2000) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan.").

Section 524 requires that "a separate class or classes of the claimants whose claims are to be addressed by a trust described in clause (i) is established and votes, by at least 75 percent of those voting, in favor of the plan." § 524(g)(2)(B)(ii)(IV)(bb).

59. *See* Plevin et al., *supra* note 33, at 292–93 ("Further compromising the pseudo FCR's independence, prospective debtors have tended to choose the pseudo FCRs from a small stable of repeat FCRs.").

60. Recognizing the importance of experience, bankruptcy courts commonly appoint the same individuals as Chapter 7, Chapter 11, and Chapter 13 trustees notwithstanding their personal interests in obtaining appointments as trustees in the future. As such, courts favor experience, integrity, and a demonstrated record over unknown or inexperienced trustees. In *In re* Frederick Petroleum Corp., 92 B.R. 273, 275 (Bankr. S.D. Ohio 1988), the court noted, "Section 321 requires only that the person elected be an individual who is competent to perform the duties of trustee . . . ." After reviewing the complex circumstances of the case, the court then refused to approve the elected trustee, stating,

> [T]his case is one for which a person found competent to serve as trustee must be someone possessing extensive bankruptcy expertise and experience. This is not a case in which the Court should appoint an individual unversed in the various causes of actions and issues which are peculiar to bankruptcy.

Id. at 275–76.

of the negotiation between the parties focuses on structuring a plan that is agreeable to the parties yet still satisfies the statutory requirements. Because of the technical nature of these discussions, prior experience becomes paramount to an FCR's ability to successfully represent the future claimants. As almost all of the foregoing concepts are unique to asbestos bankruptcies, even an experienced *bankruptcy* practitioner would have much to learn as a first-time FCR. When appointing an FCR, courts have considered candidates with extensive skills in dispute-resolution and complex litigation, experience with both asbestos litigation and bankruptcy cases, and a reputation for independence.[61] It is not uncommon for FCRs to be former judges, law professors, or attorneys with extensive experience in resolving asbestos claims.[62]

The role of FCR often requires familiarity with bankruptcy practice and Bankruptcy Code requirements, as well as experience with the litigation, negotiation, and settlement of asbestos liabilities. In recognition of the delicate balance of interests involved in the realm of conventional and prepackaged asbestos bankruptcies, bankruptcy courts have repeatedly approved the appointment of experienced FCRs in asbestos bankruptcy cases.[63] Moreover, the counsel involved in asbestos bankruptcy cases for the debtors, co-defendants, insurers, banks and current claimants are almost always very experienced from their involvement in other asbestos bankruptcies.

61. *See, e.g.*, GIBSON, *supra* note 50, at 67 (2005) ("In deciding whom to appoint, judges should look for persons with the training and experience needed to deal competently with the tort, bankruptcy, corporate, financial, and constitutional issues that will be involved in representing the interests of future claimants. To avoid conflicts of interests, judges should limit their appointments to persons who do not represent any current claimants.").

62. For example, Dean M. Trafelet (the FCR in the *Armstrong*, *Plibrico* and *USG* cases) and James J. McMonagle (the FCR in the *Eagle-Picher*, *Owens Corning*, and *Flinthote* cases) are former judges, and Eric D. Green is a law professor at Boston University School of Law. Lawrence Fitzpatrick co-founded the Center for Claims Resolution.

63. The FCRs appointed by bankruptcy courts almost always have had substantial experience in asbestos litigation, Chapter 11, complex litigation, and mediation. For example, the Honorable Dean M. Trafelet served as FCR in the *Armstrong World Industries*, *Plibrico*, and *USG* bankruptcy cases. David Austern served as FCR in the *Combustion Engineering* and *W.R. Grace* bankruptcy cases. R. Scott Williams served in the *Shook & Fletcher* and *Congoleum* bankruptcy cases. Lawrence Fitzpatrick served as FCR for the *ACandS*, *Global Industrial Technologies*, *North American Refractories Co.*, and *Pittsburgh Corning* bankruptcy cases. Professor Eric D. Green served as FCR in the *Mid-Valley*, *Federal-Mogul*, *Babcock & Wilcox*, and *Fuller-Austin* bankruptcy cases and as the Special Master in the Massachusetts, Ohio, and Connecticut asbestos litigation.

D. *Brief Overview of Conventional and Prepackaged Asbestos Bankruptcy Cases*

In a conventional asbestos bankruptcy case, the bankruptcy court appoints an FCR upon motion of the debtor (usually with the support of the committee of current claimants).[64] A potential FCR, like all other professionals employed by a debtor's estate, must disclose any potential conflicts of interest to the court.[65] To assist with carrying out his fiduciary duties, the FCR engages professionals, including lawyers and experts whose retention and compensation are also subject to bankruptcy court approval and supervision.[66] Upon appointment, the FCR's powers are often analogized to that of an official statutory committee, though they are arguably broader, given the unique role the FCR has in protecting the future claimants.[67]

Concurrent with his appointment, the FCR engages his own team of experienced professionals such as lawyers, expert statisticians, econometricians, and financial consultants.[68] The FCR and the FCR's professionals then conduct due diligence regarding the extent of the debtor's asbestos liabilities, financial assets, capital structure, ability to fund the trust, or any other factors that would influence the nature of the negotiations.[69] Following due dili-

64. *See* Tung, *supra* note 38, at 64 ("A consequence of this initial screening process by parties in interest and the court is that they have all become invested in the prospect of reorganization. The decision to appoint an FCR is an important milestone in committing to reorganization.").

65. FED. R. BANKR. P. 2014(a) ("An order approving the employment of attorneys, accountants, appraisers, auctioneers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. . . . The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.").

66. *See* Tung, *supra* note 38, at 64 (describing the various powers of the FCR).

67. Section 524 directs a court to appoint "a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such kind." 11 U.S.C. § 524(g)(4)(B)(i) (2000). Inherent in his duties is to consider whether the channeling injunction is "fair and equitable" to the future claimants "in light of benefits provided, or to be provided, to such trust." § 524(g)(4)(B)(ii).

68. An FCR in a prepack has the same ability to retain professionals to assist him in carrying out its duties and conducting due diligence.

69. *See In re* Fuller-Austin Insulation Co., No. 98-2038, 1998 U.S. Dist. LEXIS 23567, at *11–12 (D. Del. Nov. 13, 1998) (stating that the FCR engaged in "a due diligence review of (i) the business affairs of Fuller-Austin and DynCorp, including, without limitation, the nature of the relationships between them, (ii) the as-

gence, the FCR negotiates with the debtor, the committee, and other creditor constituencies in discussions that are often heated and protracted.[70] After reaching an agreement in principle, the parties draft a reorganization plan, disclosure statement, and other plan documents. The bankruptcy court then holds a hearing to determine the adequacy of the information contained in the disclosure statement.[71] The disclosure statement must be approved by the court before the debtor may solicit acceptances to the plan from creditors.[72] If the plan receives the necessary votes, the court will hold a confirmation hearing to determine whether the plan meets the requirements imposed by § 524(g) and the other sections.

A prepackaged bankruptcy differs from a conventional bankruptcy in that the plan is negotiated, voted on, and accepted by creditors before the bankruptcy petition is filed.[73] Section 1126(b) allows for the prepetition solicitation of acceptances or rejections of prepack reorganization plans without regard to whether the case involves asbestos liabilities.[74] Only after obtaining the necessary support from the FCR and current claimants will the debtor file the reorganization plan, disclosure statement, and proof of the prepack plan's acceptance, along with its voluntary petition for relief. After everything is filed, the bankruptcy court will hold a hearing to assess the adequacy of the disclosure statement and other filings and to determine whether to confirm the prepack plan. The bankruptcy court can approve the disclosure statement and confirm the

bestos litigation against Fuller-Austin, (iii) the Asbestos Insurance Actions, and (iv) the feasibility of a plan of reorganization.").

70. *See id.* at *11 (describing the negotiation process as "a six-month period during which the parties engaged in numerous, and often heated, discussions. Those negotiations first focused on the desirability of a possible plan of reorganization and second focused on the terms of such a plan.").

71. FED. R. BANKR. P. 3017(a).

72. *See* 11 U.S.C. §§ 1125(g), 1126(b) (2000); DAVID G. EPSTEIN ET AL., BANKRUPTCY § 11-22 (1993).

73. *See* EPSTEIN ET AL., *supra* note 72, at § 11-21.

74. *See* § 1126(b) ("[A] holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan.").

In a prepackaged bankruptcy, the disclosure statement may be subject to federal securities regulations, imposing stringent requirements for full disclosure. *See* EPSTEIN ET AL., *supra* note 72, at § 11-22 (discussing the differences between §1125(d) (requiring only "adequate information" in the disclosure statement) and § 1126(b)(1) (requiring "compliance with any applicable non-bankruptcy law, rule or regulation governing the adequacy of disclosure in connection with such solicitation")).

reorganization plan at the same hearing, which can occur soon[75] after the case is filed.[76]

The decision to pursue a prepackaged bankruptcy instead of a conventional bankruptcy is indeed a careful and tactical decision that requires a cost-benefit analysis involving the comparison of savings that result from a shorter stay in bankruptcy with a prepackaged plan against the increased costs of staying in the tort system for a longer period of time. For instance, companies with a robust business[77] must weigh the costs of remaining in the tort system and continuing to defend and pay claims while prepack negotiations are taking place against the potential damages and costs to the business that could result from a more prolonged Chapter 11 proceeding.[78] For a company that has insurance as a primary asset, the comparison may be a straightforward analysis of whether or not the cost of remaining in the tort system to allow time for the prepetition negotiations is less than the administrative costs of a protracted "free-fall" bankruptcy filing.

II.
REASONS FCRS SUPPORT THE USE OF PREPACKAGED ASBESTOS BANKRUPTCIES

An FCR will support a specific prepackaged bankruptcy case for a number of reasons. Paramount among those reasons is the fact that well-structured prepacks can preserve the value of a debtor's estate, particularly for a debtor whose business operations would be negatively impacted by a long stint in bankruptcy. Similarly, FCRs also support prepacks designed to benefit future claimants through the appreciation in value of the reorganized company's stock, which appreciation frequently occurs when a channeling injunction removes the asbestos overhang from the company's equity and debt securities. Even for smaller companies

75. For example, Fuller-Austin's petition was filed on September 4, 1998, and its plan was approved on November 13, 1998. *See In re* Fuller-Austin Insulation Co., No. 98-2038 (Bankr. D. Del. Nov. 13, 1998) (order approving the disclosure statement and confirming the plan of reorganization for Fuller-Austin Insulation Co.).

76. A relevant difference between a conventional asbestos bankruptcy and an asbestos prepack, however, is that in a prepack the FCR is retained by the company prior to the initiation of the bankruptcy case, but remains subject to the post-petition approval of the bankruptcy court. This point is discussed in detail in Part III.B *infra*.

77. Prepacks may not be a viable option if a company needs to restructure its commercial obligations in addition to having to resolve its asbestos liabilities.

78. *See infra* Part III.A (discussing the harm that can occur to a debtor's business in a conventional bankruptcy case).

whose primary asset may be insurance, prepacks can help to ensure that a greater percentage of the company's assets are distributed to all claimants instead of being used to pay the fees and expenses of bankruptcy lawyers and other professionals. A successful prepack also can result in the prompt establishment and funding of a § 524(g) trust so that claimants can begin receiving payments sooner than would be the case if the debtor spent years mired in bankruptcy proceedings. On the other hand, if the anticipated cost to the company of remaining in the tort system while the prepack negotiations proceed is likely to exceed the benefits of avoiding a protracted, conventional bankruptcy case, an FCR may have no incentive to participate in prepack negotiation efforts.

The traditional view taken by commentators is that an FCR's "mandate is to negotiate on behalf of future claimants, asserting their rights as creditors to their pro rata share of value in the reorganized company," which is to be accomplished by aggressive and zealous advocacy on behalf of the future claimants.[79] An FCR represents the future claimants by obtaining the most favorable settlement possible under the circumstances in the bankruptcy proceedings of an entity potentially liable to such future claimants.[80] In practice, FCRs obtain the most favorable results on behalf of the future claimants by employing aggressive negotiation tactics and positions in addition to cooperating with the company when it benefits the future claimants. If FCRs contested every aspect of a company's bankruptcy case without considering the economic implications of such contests, much of the value of the estate may be wasted (and therefore unavailable to future claimants) as a result of increased litigation costs, sizeable professional fees, and substantially greater business disruption costs.[81] Because § 524(g)

79. Tung, *supra* note 38, at 44.

80. *See id.* ("This representational device makes possible the crafting of a comprehensive settlement in bankruptcy, one that includes future claimants and disposes of their rights, along with those of other claimants. The FCR device makes possible a sort of constructive participation by future claimants, so that they may be bound to any resulting settlement.").

81. Not all parties share the incentive to have a quick, inexpensive prepack. For every year an insurer can succeed in delaying plan confirmation, it potentially can save millions of dollars. Because of the time value of money, insurers may favor lengthy, contentious bankruptcy proceedings regardless of whether the actual creditors of the estate (including the future claimants) would be worse off as a result. In this sense, "insurers are not the protectors of the future claimants . . . . The insurers' interests are adverse to those of the future claimants and the insurers cannot represent the future claimants, or act on their behalf, any more than any other adverse entity could." *In re* Mid-Valley, Inc., 305 B.R. 425, 434 (Bankr. W.D. Pa. 2004). In addition, co-defendants and insurers may see the Chapter 11 process

trusts are usually funded by significant amounts of stock in the reorganized debtor, future claimants could be negatively impacted by an FCR that conducted a scorched-earth litigation policy. With aggressive negotiations, an FCR can increase the share of the economic pie for the future claimants. However, an FCR can also increase the size of the economic pie (the value of the estate) enjoyed by all claimants by cooperating with the company when the future claimants and company have similar interests.[82] This is a subtle yet important point that has been overlooked by commentators who have examined the role of FCRs or who have criticized FCRs for having seemingly close relationships with debtors.[83]

In many cases, one of the chief ways an FCR can increase the size of the economic pie available to claimants is by negotiating a prepackaged bankruptcy case with the company. Asbestos prepacks can greatly minimize the negative impact on the debtor of a conventional bankruptcy filing.[84] During bankruptcy proceedings, a debtor may experience substantial business disruption as its management is burdened with the dual tasks of improving business operations while assisting its bankruptcy counsel and other professionals who investigate, negotiate, and litigate its asbestos liability in connection with a reorganization plan.[85] Besides being ex-

and the resulting section 524(g) trusts as opportunities to pursue agendas wholly unrelated to the bankruptcy cases. For example, co-defendants and insurers often pursue discovery of claims information from the trusts for purposes of pursuing their own defenses to asbestos personal injury lawsuits. *See* Transcript of Record at 37-39, *Chester Link v. Ahlstrom Pumps, LLC*, No. 06M-10-061 (Del. Super. Ct. Dec. 7, 2006).

82. *See generally* ROGER FISHER, WILLIAM URY, & BRUCE PATTON, GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN (1991).

83. *See* Plevin et al., *supra* note 33, at 273.

84. *See* Johnston & Porter, *supra* note 22, at 526 ("A prepackaged plan strategy allows a debtor to minimize the damage to its operations and financial prospects that could result from a free-fall bankruptcy."); *see also* 7 COLLIER ON BANKRUPTCY ¶ 1126.03[2][a] (15th ed. 2003) (explaining that prepackaged bankruptcy plans are "preferable, because they generally reflect a well thought-out reorganization attempt[,] . . . reduce the time and expense of litigation and allow a debtor to commence its reorganized operations as soon as possible"); Martha Neil, *Backing Away from the ABYSS: Courts May Be Starting to Get a Grip on Asbestos Litigation*, A.B.A. J., Sept. 2006, at 26, 32 ("Essentially, 'prepacks' allow a corporation defending against numerous claims—likely into the thousands—to develop a settlement arrangement with plaintiffs and pay the necessary funds into a trust or other mechanism before filing in bankruptcy court, where proceedings should move along smoothly since any outstanding asbestos claims have essentially been resolved.").

85. *See* Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 545 (2000) (noting that indirect costs associated with a Chapter 11 filing include

pensive, extensive bankruptcy court supervision limits management's ability to manage the debtor and capitalize on business opportunities, thus potentially impairing business operations.[86] For example, a debtor in bankruptcy must obtain bankruptcy court approval for any transaction outside of the ordinary course of the debtor's business.[87] A debtor in bankruptcy also may be less able to attract and retain talented executives and valuable employees who prefer working for companies perceived as more financially stable.[88] Customers may also be less likely to patronize a debtor in bankruptcy, particularly when warranties, prepaid services, or customer deposits are involved.[89] A well-structured prepack will decrease a debtor's time in bankruptcy, which tends to minimize the costs of the disruptive aspects of bankruptcy proceedings.

In addition, prepacks substantially reduce professional fees and expenses incurred inside of bankruptcy.[90] Conventional asbestos bankruptcies, lasting as long as six to ten years, have proven to be extremely expensive as professional fees have reached as high as a quarter of a billion dollars in some cases.[91] In a typical asbestos bankruptcy case, whether prepack or conventional, the debtor retains numerous professionals such as attorneys, financial advisors, accountants, and econometric experts.[92] The FCR and the committees appointed to represent the general unsecured creditors and current claimants are also entitled to retain professionals.[93] As the debtor's estate is responsible for all professional fees and expenses, these costs diminish the resources otherwise available to fund the

"loss in firm value due to managerial distraction, foregone investment opportunities, erosion of customer confidence, increases in employee turnover, and increased cost of supplier credit").

86. CARROLL ET AL., *supra* note 3, at 118 ("[B]ankruptcy distracts senior managers, diverting their attention from the firm's business activities to bankruptcy-related activities.").

87. *See* 11 U.S.C. § 363 (2000).

88. *See* Mark D. Plevin et al., *Where Are They Now, Part Four: A Continuing History of the Companies that Have Sought Bankruptcy Protection Due to Asbestos Claims*, Mealey's Asbestos Bankr. Rep., Feb. 2007, at 20.

89. CARROLL ET AL., *supra* note 3, at 118.

90. *See infra* text accompanying notes 95–97 (discussing professional fees and expenses in prepackaged bankruptcies).

91. *See infra* note 96 and accompanying text (discussing professional fees and expenses in *In re W.R. Grace*).

92. *See* 11 U.S.C. § 327(a) (2000).

93. *See* 11 U.S.C. § 1103(a) (2000).

recoveries of commercial creditors and current and future asbestos claimants.[94]

Because of the reduced time in bankruptcy, prepacks can save a debtor's estate millions of dollars in bankruptcy-related professional fees. [95] For instance, in *Halliburton*, a prepack asbestos bankruptcy, the total professional fees amounted to $27.6 million dollars, whereas in the conventional asbestos bankruptcy *In re W.R. Grace*, fees and expenses totaled $283.6 million dollars through September 30, 2007.[96] As such, total bankruptcy-related professional fees in well-structured asbestos prepacks have been remarkably lower (as much as eight times lower) than conventional bankruptcy filings for similarly sized companies.[97]

FCRs also support asbestos prepacks that are structured to benefit future claimants through the removal of the "asbestos overhang" clouding the value of the debtor's equity and debt securities. Section 524(g) trusts are frequently funded by substantial holdings of stock in the reorganized debtor. Because of asbestos liabilities, however, a debtor's debt and equity securities often trade at a substantial discount to their true market value (absent the asbestos liabilities). For example, Halliburton's stock fell from $40 to $8.60 over the course of one year as a result of several adverse verdicts, including a one-day, forty-three-percent drop after one such ver-

94. *See* Marc S. Kirschner et al., *Prepackaged Bankruptcy Plans: The Deleveraging Tool of the '90s in the Wake of OID and Tax Concerns*, 21 SETON HALL L. REV. 643, 645 n.9 (1991) (stating that bankruptcy "is a process . . . subject to substantial transaction costs, such as professional fees and expenses, which are paid for by the debtor but which ultimately serve to reduce distributions to creditors").

95. As a general proposition, a debtor that remains in bankruptcy for several years will incur significantly higher professional fees and business disruption costs than a debtor that reorganizes quickly—whether through a prepackaged bankruptcy or otherwise. *See* CARROLL ET AL., *supra* note 3, 119–20 ("Using a prepackaged bankruptcy approach, plaintiff attorneys and debtors anticipate reducing the time from petition to approval to as little as three to six months, with comparable savings in bankruptcy litigation costs."); *see also* James L. Stengel, *The Asbestos End-Game*, 62 N.Y.U. ANN. SURV. AM. L. 223, 261 (2006) ("[T]he direct costs of BANKRUPTCY in terms of professional fees are high and are positively related to the duration of the reorganization.").

96. *Compare In re* Mid-Valley, Inc. (*Halliburton*), No. 03-35592 (Bankr. W.D. Pa. Apr. 15, 2005) (omnibus order approving professionals' final fee applications), *with In re* W.R. Grace & Co., No. 01-1139 (Bankr. D. Del. 2001).

97. The total professional fees in *Fuller-Austin*, a relatively small prepackaged asbestos bankruptcy case, were $831,989.90. *See In re* Fuller-Austin Insulation Co., No. 98-2038 (Bankr. D. Del. Mar. 3, 1999) (order approving final fee applications). As a point of comparison, "the fees and expenses for the Manville BANKRUPTCY were approximately $100 million in 1988 dollars." Stengel, *supra* note 95, at 261.

dict.[98] As a result, Halliburton faced potential downgrades in credit ratings that would have impaired its access to credit and thus its ability to pursue profitable projects.[99] After a bankruptcy court issues a channeling injunction, however, the value of such stock typically appreciates immediately as the effect of the asbestos overhang is eliminated.[100] Because a reorganized debtor can often access the capital markets on more favorable terms after its completed bankruptcy case, it is better able to pursue profitable projects resulting in further appreciation in its stock value.[101] Because § 524(g) trusts are often funded by stock in the reorganized debtor, claimants also benefit from appreciation in the debtor's stock that often occurs upon issuance of the channeling injunction.

A benefit universal to all § 524(g) trusts is that they can diversify the risks borne by claimants by virtue of the fact that payment of their claims may no longer depend on the success of a single company. This risk applies with particular force to the future claimants who, by definition, are unable to pursue their recoveries until some time in the future. Even if a company is financially viable at present, there is no guarantee that it will still be financially viable (or even in existence) only a few years later.[102] As involuntary tort creditors, tort claimants did not choose to do business with a company based on its ability to pay their tort claims. Instead, the asbestos claimants (especially those whose injuries will take decades to manifest) are held hostage to market forces that dictate whether the company will remain a financially viable entity when their claims mature. A § 524(g) trust is still dependent on the success of the reorganized debtor to the extent that it is funded by some, if not all, of the reorganized debtor's stock. However, trust documents generally provide the trustees with the ability to take advantage of stock-market fluctuations to sell the trust's holdings at opportune moments, and to diversify the trust's assets into low-risk assets such as treasury notes or other high-quality debt instruments.

98. *See Mid-Valley Findings*, *supra* note 26, at 10–11 ("Two days after the last of the four verdicts, Halliburton's stock price dropped 43% in a single day of trading. By January 2002, the Halliburton stock had fallen to $8.60 per share. . . . The verdicts/judgments also adversely affected the status of Halliburton's public debt. Late in 2001 and early in 2002, certain agencies lowered their ratings of Halliburton's long-term senior unsecured debt. According to the ratings agencies, these ratings were lowered primarily due to concerns about the asbestos and silica liabilities of Halliburton and its affiliates.").

99. *See id.* at 11 ("The agencies indicated that, absent a global settlement of asbestos claims, Halliburton's ratings would continue to be under consideration for possible downgrades. With each downgrade, the cost of new borrowing became higher and the company's access to debt and financial markets became more restricted. The markets' reaction to the verdicts/judgments also affected Halliburton's liquidity and, potentially, its ability to obtain new business by restricting its access to capital which, in turn, impacted the Debtors' liquidity and ability to conduct ongoing business operations.").

100. *See infra* notes 189–94 and accompanying text (describing the removal of the asbestos overhang of Halliburton's stock).

101. *See* CARROLL ET AL., *supra* note 3, at 118 ("[Bankruptcy] impairs, or entirely eliminates, access to credit.").

102. *See* Listokin & Ayotte, *supra* note 37, at 1437–38 ("Early BANKRUPTCY filings can protect future claimants, enhance firm value, and reduce legal costs. When a firm facing large future TORT liabilities delays a filing, it must compensate present claimants in full. This procedure ensures that future claimants will be relatively under-compensated if the firm becomes insolvent at a later date."); Schultz, *supra* note 5, at 562–63 ("In reality, . . . the pool of capital available to compensate present and future plaintiffs frequently turns out to be exhausted before they even get into the courthouse.").

103. *See* Plevin et al., *supra* note 33, at 292 ("In choosing this pseudo FCR, prospective debtors and current claimants are unlikely to choose the most formidable adversary against whom to negotiate. Instead, they are likely to seek someone more pliant and cooperative.").

III.
FACTORS DISCIPLINING A DEBTOR'S PREPETITION SELECTION OF AN FCR

This section analyzes several factors that discipline a company's selection of a prepetition FCR, including forces in the capital, product and services, and labor markets. Any missteps caused by an ill-advised selection of an FCR may greatly increase the length of the reorganization process and, as a result, may substantially increase the company's business disruption costs, professional fees, and other bankruptcy-related expenses. Moreover, the company is further influenced by the possibility of losing control of its reorganization process when the exclusivity period terminates. In addition, a company also has an interest in preserving a favorable factual record—which will be created in part by the retention of an experienced, independent FCR—to fully ensure that the validity of the channeling injunction will not be subject to collateral attack.

The selection of a qualified, independent FCR is critical to the success of a prepack. Some commentators have suggested that a debtor is likely to select a weak FCR that is beholden to it or to the current claimants.[103] Interestingly, the same commentators have criticized debtors for choosing "repeat players" (i.e., ones that are experienced and who have previously received the imprimatur of

the court) as FCRs.[104] From a debtor's perspective, however, the worst conceivable scenario would be to incur the expenses of a prepack filing only to have the prepack unravel as the court either fails to approve the FCR post-petition or declines to confirm the reorganization plan negotiated by the FCR.[105]

Market forces, business-disruption costs, and transaction costs may be significantly decreased by the retention of an independent, disinterested FCR, which in turn helps to ensure timely consummation of the prepackaged bankruptcy case. In addition, retaining an independent and disinterested FCR will reduce the uncertainties attending a debtor's case. The factors and forces discussed above, when combined with bankruptcy court supervision and the Bankruptcy Code sections and Bankruptcy Rules governing disclosure and disinterestedness, provide strong assurances that the future claimants will receive vigorous and independent representation.[106]

A. Market Pressures to Emerge from Bankruptcy Quickly and Minimize Professional Fees Strongly Influence and Endorse Prepack Filings

The convergence of market forces with the rulings rendered during a bankruptcy case will largely determine how bankruptcy proceedings impact a debtor's going-concern value. This is particularly true where a debtor's stock or the stock of its parent company continues to be publicly traded during the course of its reorganization proceedings. Any misstep, including the failure to obtain court approval of an FCR or having his or her retention subsequently overturned, could immediately and seriously impact such debtor's stock value. In addition, as a result of the bankruptcy filing, a debtor may be less able to obtain credit, whether from trade vendors, banks, or the capital markets through debt or equity securities. Besides competing in capital markets, debtors face strong competition in the goods, services, and labor markets. Bankruptcy proceedings, particularly those in conventional "free-fall" bankruptcies, may substantially disrupt a debtor's ability to carry on business

104. *See id.* at 292–93 ("Further compromising the pseudo FCR's independence, prospective debtors have tended to choose the pseudo FCRs from a small stable of repeat FCRs.").

105. *See* Vairo, *supra* note 4, at 107 ("There are risks, however: for example, if parties dissatisfied with the proposed plan persuade the BANKRUPTCY court to disapprove the disclosure statement used to solicit pre-petition acceptances of the plan or the 'futures representative' selected to take part in the pre-petition negotiations, the BANKRUPTCY case may take longer than anticipated, and any pre-petition deals could unravel.").

106. *See* 11 U.S.C. § 327 (2000); FED. R. BANKR. P. 2014(a).

as normal.[107] Moreover, a debtor's difficulties may be exacerbated if customers and employees search for more stable and reliable suppliers and employers. The failure to promptly obtain court approval of the FCR or the prepackaged plan will severely delay the case and exacerbate all the costs, burdens, and negative publicity associated with the bankruptcy filing, all of which further decreases the debtor's ability to compete in the goods, services, labor, and capital markets.

While conventional asbestos bankruptcy cases historically have involved some risks and uncertainties,[108] the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (hereinafter "BAPCA") may have increased those risks. For example, prior to the BAPCA amendments, a debtor could request virtually unlimited extensions of the exclusivity period.[109] The exclusivity period is now limited to the first 120 days after the bankruptcy filing in which time the debtor is the sole party permitted to file a plan of reorganization.[110] The debtor can request extensions, but under a provision in the BAPCA amendments, the exclusivity period cannot

107. For example, in a bankruptcy proceeding, the simple act by the debtor of employing the same professionals it employed prepetition can become a tedious and expensive undertaking.

108. *See* Stengel, *supra* note 95, at 268 ("[T]he risks are well known: by filing, the debtor places the entire equity value of the company at risk; the debtor can lose control of the process; the courts may or may not be willing to engage in extensive pre-confirmation litigation, and potential litigation can result in losses; transaction costs are high and delay is inevitable; and, at the end of the day, a deal of some sort with certain TORT claimants and the future class representatives will be necessary.").

109. In *W.R. Grace*, the debtors received nine exclusivity extensions. In denying the debtors' tenth motion to extend the exclusivity period, the bankruptcy court stated:

> [D]espite over six years of exclusivity, Debtors have been unable to forge an agreement or achieve a consensus with respect to asbestos personal injury liabilities and certain asbestos-related property damage claims . . . ; Debtors have had sufficient exclusive time to control negotiations with creditors and propose and confirm a feasible plan; . . . Debtors have failed to establish that extending exclusivity will result in advancing the case towards resolution; . . . termination of exclusivity will facilitate moving the case toward conclusion by changing the dynamics for negotiation while permitting Debtors to continue to operate their businesses, resolve claims, and participate in negotiations; . . . Debtors have not shown additional cause for extension of exclusivity and the Court finds that termination of exclusivity will not prejudice any party or adversely affect the progress of the case pending estimation . . . .

In re W.R. Grace & Co., No. 01-1139 (Bankr. D. Del. July 26, 2007) (order denying extension of exclusivity and terminating same).

110. Under the BAPCA amendments, debtors have a maximum exclusivity period of eighteen months. *See* 11 U.S.C. § 1121(d)(2)(A) (2000).

extend beyond eighteen months.[111] Section 1121 of the Bankruptcy Code does not expand or otherwise modify the exclusivity period limits for a debtor with asbestos liabilities.[112] After the exclusivity period terminates, any party-in-interest (including the FCR, the asbestos claimants' committee, bondholders, or equity creditors) is permitted file a proposed reorganization plan.[113]

The uncertainty caused by the limited exclusivity period is compounded by the fact that the debtor does not necessarily possess an absolute right to dismiss its case once it files a voluntary petition.[114] As a result, there is always the possibility that a debtor could lose control of its case when the exclusivity period terminates and eventually become subject to a plan of reorganization proposed by another party.[115] A company thus would be ill-advised to file an asbestos prepack without undertaking every effort (including retaining an independent and disinterested FCR early in negotiations) to ensure that confirmation occurs before the exclusivity period terminates.[116]

111. *See id.* ("The 120-day period specified in paragraph (1) may not be extended beyond a date that is 18 months after the date of the order for relief under this chapter.").

112. *See id.*

113. *See* § 1121(c) ("Any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may file a plan . . . ."); *see also In re* Babcock & Wilcox Co., No. 00-10992, (Bankr. E.D. La. May 8, 2002) (order denying debtors' motion to extend exclusivity period for filing a Chapter 11 plan and disclosure statement).

114. *See* Camden Ordnance Mfg. Co. of Ark., Inc. v. United States Tr. (*In re* Camden Ordnance Mfg. Co. of Ark., Inc.), 245 B.R. 794, 805 (E.D. Pa. 2000) (rejecting the debtor's argument that it had an absolute right to dismiss its voluntary Chapter 11 case). When affirming the bankruptcy court's denial of the debtor's motion to dismiss, the district court in *Camden Ordnance* stated:

> Once a debtor submits to the jurisdiction of the bankruptcy court and avails itself of bankruptcy protections, the debtor must comply with the Bankruptcy Code. . . . [The debtor] was not compelled to seek protection in bankruptcy and thus, following the statutory framework of the Bankruptcy Code is a fair and necessary requirement for a debtor seeking the benefits of bankruptcy.

Id. at 805.

115. For example, in *In re* Congoleum, Continental Casualty Company and Continental Insurance Company, the Official Committee of Bondholders, and R. Scott Williams, the Futures Representative, each filed their own plans and disclosure statements after the bankruptcy court terminated exclusivity on November 9, 2005. *In re* Congoleum Corp., No. 03-51524 (Bankr. D.N.J. 2003).

116. Recent cases, including *Congoleum*, demonstrate the risks that a debtor hazards by its inability to confirm a reorganization plan. Even for cases filed before the BAPCA Amendments, there is the risk that a bankruptcy court will eventually terminate the exclusivity period. Once the exclusivity period is terminated, a bankruptcy court lacks the power to reinstate it. *See* § 1121(d)(2)(A).

Another consideration is the enforceability and finality of the channeling injunction issued pursuant to § 524(g).[117] The Bankruptcy Code contains procedural protections to ensure that channeling injunctions cannot be modified or overturned.[118] However, as is true with any law or legislation, there is no way to predict with complete certainty how channeling injunctions issued under § 524(g) will be treated by Congress or the Supreme Court many years in the future.[119] Accordingly, a debtor always has an interest in preserving a factual record free of conflicts of interest in order to protect against a collateral attack on the channeling injunction by future claimants. By preserving a favorable factual record, the debtor helps to fully ensure that future claimants will be bound for all time to the terms of the reorganization plan and the channeling injunction.[120]

117. *See* Johnston & Porter, *supra* note 22, at 513–14 ("This ability to end all tort litigation against the debtors and its [sic] affiliates and to segregate such activity into actions against the trust gives § 524(g) the power to put a complete rest to asbestos litigation that has plagued a debtor for years.").

118. Section 524(g) provides that the channeling injunction "shall be valid and enforceable and may not be revoked or modified by any court except through appeal in accordance with paragraph (6)." 11 U.S.C. § 524(g)(3)(A)(i) (2000).

Section 524(g) then limits challenges to the channeling injunction to direct challenges to the injunction or the confirmation order: "Paragraph (3)(A)(i) does not bar an action taken by or at the direction of an appellate court on appeal of an injunction issued under paragraph (1) or of the order of confirmation that relates to the injunction." § 524(g)(6).

Section 524(g) then makes a collateral attack on the injunction more difficult by requiring all actions contesting the channeling injunction, or the Code subsection authorizing the injunction, be brought in the same district court that issued the injunction:

> [T]hen after entry of such injunction, any proceeding that involves the validity, application, construction, or modification of such injunction, or of this subsection with respect to such injunction, may be commenced only in the district court in which such injunction was entered, and such court shall have the exclusive jurisdiction over any such proceeding without regard to the amount in controversy.

§ 524(g)(2)(A).

119. *See In re* Fuller-Austin Insulation Co., No. 98-2038, 1998 U.S. Dist. LEXIS 23567, at *63 (D. Del. Nov. 13, 1998) ("The appointment of the Legal Representative and his participation in the Reorganization Cases is sufficient to bind the holders of future Asbestos Claims or Demands under the Plan and affords such holders due process.").

120. *See* Tung, *supra* note 38, at 54 ("Other parties in interest also have a stake in assuring that due process is accorded to future claimants. A failure of due process would preclude the bankruptcy from affecting future claimants' legal rights.

B. Selecting a Disinterested and Independent Future Claimant Representative

When all of the factors influencing a debtor's desire to confirm a plan quickly are considered, including the desire to minimize disruptions or the risk of a collateral challenge, it is readily apparent that retention of a prepetition FCR who is both qualified and independent is of paramount importance.[121] Courts have allowed the debtor and current claimants committee to participate in the selection of an FCR during a conventional bankruptcy filing.[122] The fact that the same parties also participate in the selection of an FCR prior to a prepackaged bankruptcy filing does not in and of itself taint the FCR selection process. Moreover, the bankruptcy court has the power to fully scrutinize the candidate in connection with a proposed post-petition appointment.[123]

That of course would frustrate the primary purpose of the bankruptcy filing—to achieve a comprehensive and final settlement of all future claims liability.").

121. *See supra* Part III.A (describing multiple reasons why debtors select disinterested and independent FCRs).

122. *See, e.g., In re* Armstrong World Indus., Inc., Case No. 01-04471 (Bankr. D. Del. Jan. 24, 2002) ("[T]he Creditors' Committee, the Asbestos PI Committee, AWI, and their respective advisors have evaluated and/or interviewed several potential candidates to serve as a Future Representative. Following careful consideration of the potential candidates . . . the Debtors have determined, in their sound business judgment, that Dean M. Trafelet . . . should be appointed as the Future Representative for the Future Claimants. Both the Creditors Committee and the Asbestos PI Committee fully the support the instant Application and . . . Mr. Trafelet is 'disinterested' as such term is defined in Section 101(14) of the Bankruptcy Code."); *In re* Forty-Eight Insulations, Inc., 58 B.R. 476, 478 (Bankr. N.D. Ill. 1986) ("The Court will order that the U.S. Trustee select, in consultation with the debtor and the Committee, a qualified individual to serve as legal representative of the potential claimants.").

123. *See* GIBSON, *supra* note 50, at 122 ("A judge presented with a prepackaged mass tort plan needs to be fully informed about the circumstances surrounding the prepetition negotiations in order to determine whether the process has been tainted by conflicts of interest or self-interested actions by the participants.").

> We do not approve of a bankruptcy court applying less than careful scrutiny to pre-petition procedures in pre-packaged plans. The parties here seek the court's *imprimatur* of a reorganization that will free the debtor of all current and future asbestos liability. The legitimacy of such a transaction is dependent on the stature of the court.
>
> In a pre-packaged setting, most of the work on a plan of reorganization that would occur in a 'traditional bankruptcy' happens before the debtor files its petition. For a court to approve a pre-packaged plan whose preparation was tainted with overreaching, for example, would be a perversion of the bankruptcy process.
>
> . . . .
>
> As this case demonstrates, leaving the procedures for allocation of resources predominantly in the hands of private, conflicting interests has led to problems of fair and equal resolution. The need for counsel with undivided loyalties is more pressing in cases of this nature than in more familiar conventional litigation. Correspondingly, the level of court supervision must be of a high order.

Century Indem. Co. v. Congoleum Corp. (*In re* Congoleum Corp.), 426 F.3d 675, 692–93 (3d Cir. 2005).

Congress's implementation of § 524(g) in 1994 as part of the Manville Amendments did not change (nor has Congress since changed) any of the sections of the Bankruptcy Code that regulate the independence of professionals, like the FCR, whose employment is subject to bankruptcy court approval.[124] Congress has not enacted specialized rules governing the appointment and independence of the FCR explicitly contemplated in § 524(g)(4)(B)(i).[125] As a result, bankruptcy courts since 1994 have applied the existing Bankruptcy Code standards when considering the appointment of the FCR.[126] In addition, the FCR, like all professionals compensated from the debtor's estate, must disclose all connections to the debtor or other parties involved in the case.[127] Ultimately, it is the

124. *See* 11 U.S.C. §§ 101(14), 327, 328, 1103 (2000); FED. R. BANKR. P. 2014(a).

125. 11 U.S.C. § 524(g)(4)(B)(i) (2000).

126. Courts have cited §§ 524(g), 101(14), 327(a), and 1103(b) in appointing FCRs. *See, e.g., In re* W.R. Grace & Co., No. 01-01139 (Bankr. D. Del. May 24, 2004) (order granting application of Debtor pursuant to 11 U.S.C. §§ 105, 327 and 524(g)(4)(B)(i), for the appointment of a legal representative for future asbestos claimants); *In re* Congoleum Corp., No. 03-51524 (Bankr. D.N.J. Feb. 18, 2004) (order authorizing the appointment of R. Scott Williams as futures representative); *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. Feb. 18, 2004) (final order granting debtors' application to appoint legal representative for purposes of sections 105 and 524(g) of the bankruptcy code); *In re* Armstrong World Indus., Inc., No. 00-04471 (Bankr. D. Del. Mar. 1, 2002) (order appointing legal representative for future claimants).

However, because § 327(a) explicitly applies to the professionals of the trustees (or the debtor-in-possession), FCRs generally take the position that § 1103(b) governs the independence of FCRs because that section is not specifically limited to a trustee (or debtor-in-possession). *Compare* 11 U.S.C. § 327(a) ("Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title."), *with* 11 U.S.C. § 1103(b) ("An attorney . . . employed to represent a committee appointed under §1102 of this title may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case.").

127. Bankruptcy Rules require a professional to disclose all of the person's connections with the debtor, creditors, any other party in interest, their respective

court, and not the debtor or other parties adverse to the future claimants, who will determine whether the FCR is sufficiently independent to represent the future claimants.

Some have argued that since in a prepack the FCR and the FCR's professionals are compensated and selected prepetition by the debtor, the FCR should be ineligible to serve as the post-petition FCR. [128] Several courts, however, have determined that the process of prepetition selection of the FCR by the debtor and its creditors, and subsequent plan negotiations among the parties in a prepack, does not disqualify the prepetition FCR from serving post-petition, nor does it make the prepack unconfirmable.[129] For example, Judge Farnan made findings in *Fuller-Austin* that the prepetition selection and compensation of the FCR would not prejudice or conflict with his duties owed to the future claimants:

> The FCR's "investigation of the Debtor's affairs prior to the commencement of this case, his participation in the negotiation of a reorganization plan with the Debtor and other interested parties prior to the commencement of this case, his retention of professionals for the purpose of assisting in the foregoing prior to the commencement of this case, and his receipt and his professionals' receipt of payments from the Debtor in connection with the foregoing investigation and negotiation prior to the commencement of this case, would not conflict with his obligations as the legal representative in this case."[130]

attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." FED. R. BANKR. P. 2014(a).

128. *See* Plevin et al., *supra* note 33, at 326 ("[T]he fact that someone was hired pre-petition by the debtor and current claimants to serve as pseudo FCR in connection with a pre-packaged asbestos bankruptcy should be sufficient to *disqualify* the pseudo FCR from court appointment as the statutory FCR. Whatever service or utility the pseudo FCR might provide in developing a plan pre-petition, that service cannot be used as the springboard for appointment as the statutory FCR, post-petition. The conflicts of interest are simply too great.").

129. *See, e.g.*, Transcript of Omnibus Hearing at 24, *In re* Combustion Engineering, Inc., No. 03-10495 (Bankr. D. Del. Mar. 24, 2003) ("Well, with respect to the payments that Mr. Austern received from the debtor, I'm—since he was functioning in the capacity of an entity or person representing the futures before the bankruptcy, I'm not quite sure why that causes some problem if he's appointed to represent the same group of people in the bankruptcy because he's going to get paid from the debtor's estate anyway."); Transcript of Hearing at 31–37, *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. Feb. 13, 2004).

130. *In re* Fuller-Austin Insulation Co., No. 98-2038 (Bankr. D. Del. Sep. 9, 1998).

Likewise, courts have rejected the argument that it is a conflict for the FCR to receive his compensation from the debtor in the context of prepack negotiations. In *Halliburton*, Judge Fitzgerald stated that

> in a bankruptcy case, all representatives appointed by the court are compensated from the estate. The FCR in this case provided a service standing in the shoes of unknown future claimants at the expense of the Debtors. Nothing untoward can be found by virtue of the fact of that arrangement, in and of itself.[131]

Furthermore, Judge Fitzgerald noted:

> That the proposed FCR is being paid by the Debtors does not, *a fortiori*, render him unable to protect the interests of his constituency. *If that were the case there could be no FCRs in any asbestos case since all are paid by the debtor until the plan is confirmed.*[132]

Judge Fitzgerald also noted that the subsequent employment of the FCR by the proposed § 524(g) trust would not require the rejection of his appointment as FCR during the bankruptcy case.[133] Given that courts have repeatedly found that there is no conflict created by the appointment of an FCR that has served in that same capacity prepetition, and given that the Bankruptcy Code nowhere prohibits the use of a prepetition FCR, there is no compelling reason to now create a rule banning this practice. This is especially true given that a prohibition against allowing a prepetition FCR to continue to serve post-petition would effectively terminate the use of prepacks in asbestos cases, which have been shown to provide valuable benefits for future claimants and other parties involved in bankruptcy cases.

131. *In re* Mid-Valley, Inc. (*Halliburton*), 305 B.R. 425, 434 (Bankr. W.D. Pa. 2004).

132. *Id.* at 434–35 (emphasis added).

133. *In re* Mid-Valley, Inc., Findings of Fact and Conclusions of Law, No. 03-35592, at 27 (Bankr. W.D. Pa. July 16, 2004) (finding that the "Legal Representative will continue to serve as representative for the future and unknown Asbestos and Silica PI Trust Claimants from the Effective Date onward" and that the continuation of the FCR "in such capacity is merited and consistent with the interests of future claimants on whose behalf he will act."); Memorandum of Oral Opinion Read Into the Record at 15, *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. Feb. 11, 2004) ("The Plan's proposal to retain the FCR to work with the trustees of the Asbestos PI Trust is not a mandate for his removal or the denial of his appointment.").

IV.
COMMON PROBLEMS WITH PREPACKAGED ASBESTOS BANKRUPTCY FILINGS

As described in Part II, there are numerous reasons why FCRs support asbestos prepacks in order to effectively represent the future claimants. Once an FCR comes to an agreement with the company and current claimants, the parties want the resolution embodied in their joint plan of reorganization to be confirmed. Nevertheless, much of the benefit of an asbestos prepack can be lost if the prepack unravels and turns into a lengthy reorganization case. Thus, it is important for an FCR to ensure that the prepack is structured in such a way that the value of the negotiated deal (usually including stock in the reorganized debtor) is preserved by avoiding some pitfalls experienced in recent asbestos prepacks. As an overarching principle, the parties must avoid structuring reorganization plans—prepack or otherwise—such that the settling current claimants are unfairly preferred over the non-settling current and future claimants.[134]

A. Eliminating Conflicts of Interest from Pre- and Post-petition Negotiations

In order to prevent a prepack case from stalling indefinitely, the parties should endeavor to avoid conflicts of interests among the debtor's professionals, current claimants, the FCR, and the FCR's professionals. Challenges to the FCR or any of the parties' professionals risk delaying the proceedings and embroiling the parties in costly litigation. Such delays can negate much, if not all, of the advantages associated with a prepack.

For instance, in *Century Indemnity Co. v. Congoleum Corp.*, the Third Circuit reasoned that the debtor's special insurance counsel, retained prepetition by the debtor to assist in negotiations with current claimants, had an actual conflict of interest in that it also represented, as co-counsel for insurance matters, certain current asbestos personal injury claimants who alleged claims against the debtor.[135] In its engagement letter, the firm disclosed to the debtor the nature of its prepetition representation of certain current claimants and obtained a waiver from the debtor.[136] However, certain insurers objected to the retention of the firm post-petition.[137] Notwithstanding the firm's disclosures to the bankruptcy court that it represented these claimants, the Third Circuit held that the firm was not disinterested.[138] As a result, the Third Circuit held that the firm's retention violated § 327(a).[139] On remand, the bankruptcy court ordered the debtor's proposed insurance counsel to disgorge $9.6 million in fees and expenses and denied $3.3 million in additional fee requests.[140] The parties in *Congoleum*, after ten plans and four years, have been unable to confirm a plan. The litigation over the conflict at the commencement of the case more than likely has contributed to the lengthy reorganization process.

134. *See In re* Combustion Eng'g, Inc., 391 F.3d 190, 239 (3d Cir. 2004).

135. *See* 426 F.3d 675, 692 (3d Cir. 2005) (overturning the retention of special counsel).

136. *See id.* at 681–82.

B. Retaining the Future Claimant Representative Before the Company's Assets are Committed to Settlements with Current Claimants

To ensure the confirmation of an asbestos prepack, an FCR should be retained before the parties engage in substantive negotiations and before a company irrevocably commits any assets pursuant to settlements made in anticipation of the bankruptcy filing. For instance, in *Combustion Engineering* the parties engaged the FCR late in the prepetition negotiations after certain bankruptcy-related settlement agreements were nearly final.[141] In the bankruptcy proceedings, certain parties argued that the FCR was retained too late to be effective since a substantial percentage of the debtor's assets were already committed to a prepetition trust established for the settling current claimants.[142] The Third Circuit agreed with the ob-

137. *See id.* at 683.

138. *See id.* at 692.

139. *See id.*.

140. *In re* Congoleum Corp., No. 03-51524 (Bankr. D.N.J. Mar. 27, 2006).

141. The FCR was retained around October 29, 2002. *See* Transcript of Omnibus Hearing, *supra* note 129, at 18.

142. In the bankruptcy court proceedings, certain objecting claimants argued that the FCR in the case was not appointed early enough to be effective:

> [W]e think that he accepted the restriction, when he was employed—at the time he was employed, it was before the pre-petition trust was created, we believe that he accepted the debtor's restriction, and the plan proponent's restriction, indeed, not to look to 85 percent of the debtor's assets, that—those were off the table, and limited his assessment to the remaining 15 percent and the assets contributed by others, and said, with all those assets off the table paying present [claimants], that's part of the deal, those are off the table, your evaluation, as future claimants representative, is limited, and only can involve this smaller, this little tiny bundle of assets from the debtor and the others, and in that context, it is your job, as the future claimants representative, to make the determinations that you're going to make as the future claims rep regarding fair and equitable, and protecting the futures.

jecting parties, finding that the debtor and current claimants had already negotiated the structure of the prepack plan by late October 2002, or about the same time the FCR was retained.[143] Accordingly, the Third Circuit found that "a disfavored group of asbestos claimants, including the future claimants and the Certain Cancer Claimants, were not involved in the first phase of this integrated settlement" and vacated the bankruptcy court's order confirming the plan.[144] The Third Circuit also found that Combustion Engineering had contributed nearly half of its assets to the prepetition trust, which obviously diminished the amounts available to future claimants.[145]

The case of ACandS is also illustrative of the risks to which prepacks are exposed when an FCR is not engaged early enough in the plan negotiation process. ACandS operated as an insulation contracting company from 1958 to 2001, when it was overrun by mounting asbestos liabilities.[146] From 1981 to 2002, ACandS resolved 247,000 asbestos claims.[147] In 2001, ACandS's aggregate asbestos liability costs were three times those for 1999 and double those for 2000.[148] In an effort to develop a prepack, the debtor pursued, on dual tracks, settlement negotiations with current claimants and negotiations with its insurers. Both tracks of negotiations occurred without the involvement of an FCR.[149] For those claimant settlements that the debtor could not immediately fund from insurance proceeds, the debtor granted security interests in future insurance proceeds.[150]

In re Combustion Engineering, Inc., Hr'g Tr., Case No. 03-10495 at 145 (Bankr. D. Del. Apr. 18, 2003).

143. *See In re* Combustion Eng'g, Inc., 391 F.3d 190, 204 (3d Cir. 2004).

144. *Id.* at 245, 248.

145. *See id.* at 201 ("To this end, Combustion Engineering contributed half of its assets to a pre-petition trust . . . to pay asbestos claimants with pending lawsuits for part, but not the entire amount, of their claims.").

146. *See* Disclosure Statement Pursuant to Section 1125 of the Bankr. Code at 17, *In re* ACandS, Inc., No. 02-12687 (Bankr. D. Del. Oct. 3, 2003).

147. *See id.* at 18.

148. *See id.*

149. *See id.* at 27 ("Beginning in the Fall of 2001 . . . ACandS began to discuss with Travelers Casualty and certain plaintiffs' lawyers alternatives to ACandS remaining in the tort system . . . ."); Notice of Debtors' Motion for Entry of an Order Approving & Authorizing the Appointment of Lawrence Fitzpatrick as the Legal Representative to Future Asbestos Claimants at 10, *In re* ACandS, Inc., No. 02-12687 (Bankr. D. Del. Dec. 24, 2002) ("At no time did Mr. Fitzpatrick, as part of his engagement or otherwise, have any plan related or substantive negotiations with the Debtor prepetition.").

150. *See In re* ACandS, Inc., 311 B.R. 36, 39 (Bankr. D. Del. 2004) ("In anticipation that Travelers Casualty might refuse to honor its coverage obligations and because ACandS did not have significant non-insurance assets to fund ongoing settlements, ACandS decided to attempt to settle trial-listed and other asbestos-related bodily injury claims at fair values in consideration for an assignment to settled asbestos claimants of interests in and proceeds from specified insurance policy limits. ACandS also established the Pre-Petition Trust to, among other things, hold a security interest in certain ACandS insurance proceeds for the benefit of the settled asbestos plaintiffs.").

The debtor was left with minimal cash and few unencumbered assets once the negotiations with its insurers broke down. Lacking assets to fund a § 524(g) trust, the prepack negotiations faltered, and on September 16, 2002, ACandS filed a conventional bankruptcy case.[151] By the time the bankruptcy case was actually filed and an FCR was appointed by the court,[152] ACandS had little cash to fund a § 524(g) trust and limited means to ensure that the future claimants would recover any substantial value from such trust.[153]

An unfavorable arbitration decision rendered after the bankruptcy filing "effectively terminat[ed] ACandS's insurance coverage" and all but guaranteed that no insurance coverage would be available to future claimants.[154] The ruling meant that virtually no insurance proceeds would be available to pay claims not yet settled (i.e., no insurance proceeds would be available to future claimants), but left open the question of the availability of insurance proceeds for claims settled before the ruling was issued.[155] This left the debtor and the FCR in a difficult position in which possibly the only substantial asset available to pay future claimants was whatever value could be negotiated from the holders of those settlements for

151. Voluntary Petition, *In re* ACandS, Inc., No. 02-12687 (Bankr. D. Del. Sept. 16, 2002).

152. *See In re* ACandS, Inc., 311 B.R. at 38 ("[I]t is fair to say that as of September 16, 2002 . . . the company was and is essentially moribund.").

153. *See id.* at 38, 40 ("[T]he only real hope for recovery for most of its approximately 300,000 asbestos claimants holding some $3 billion in claims hinges on success in its coverage claims against Travelers. . . . Unless the trust realizes a resounding victory in its coverage dispute with Travelers, it is unlikely that claimants in the unsecured category will receive anything.").

154. ACandS, Inc. v. Travelers Cas. & Sur. Co., 435 F.3d 252, 260 (3d Cir. 2006).

155. *See* Transcript of Proceedings at 189, *In re* ACandS, Inc., No. 02-12687 (Bankr. D. Del. Dec. 12, 2003) (testimony of Lawrence Fitzpatrick) ("Under [the July 31, 2003, arbitration decision,] the current claimants, at least those who settled prior to the date of the decision . . . can make an argument that they're entitled to forty-five percent of all of ACandS's settlements up to the date of the settlement because that was the agreement that ACandS and Travelers had prior to the time of the arbitration. That amount is $1.26 billion as computed by the debtor. [Future claimants] by definition cannot have settled prior to July 30th–31st, rather, 2003. So under the arbitrator's decision, as it reads, they are entitled to nothing.").

which insurance proceeds potentially remained available, but only if the debtor prevailed in its litigation over whether insurance coverage remained available for those settlements.[156]

It was against this backdrop that the court denied confirmation, in essence finding that the plan did not satisfy § 524(g) because it provided no assurance that the trust would provide future claimants with a fair recovery.[157]

C. *Avoiding Two-Trust Structures or Payments Outside a Reorganization Plan*

To ensure court approval of their reorganization plan, parties should generally avoid utilizing a two-trust structure that treats settling claimants differently from non-settling and future claimants. In *Combustion Engineering*, the Third Circuit vacated a prepack plan that provided payments to current claimants from a prepetition trust and payments to non-settling current and future claimants from a post-petition trust.[158] Viewing the two-trust structure as an integrated whole, the Third Circuit found that the plan lacked the required equality of distribution among creditors.[159] The court found that under the reorganization, settling current claimants were to receive, on average, fifty-nine percent of the liquidated value of their claims while future claimants would recover approximately eighteen percent of the liquidated value of their claims under the post-petition trust.[160]

In addition to the differing treatment of current and future claimants under the two-trust structure, the Third Circuit was troubled by the process by which the plan was negotiated and voted upon, including the use of so-called "stub claims" and "artificial impairment."[161] Stub claims are claims that are substantially paid

156. *See id.* at 188–89 ("[The July 31, 2003, arbitration decision] . . . was a potential disaster for the future claimants. . . . I concluded that living with the existing plan structure where my clients had the chance of sharing in a $1.26 billion pot versus the alternative, which was nothing was a pretty easy decision to make . . . ."); *In re* ACandS, Inc., 311 B.R. at 38, 40. The Third Circuit later overturned the arbitration panel's decision as violating the automatic stay. *See* ACandS, Inc. v. Travelers Cas. & Sur. Co., 435 F.3d at 261.

157. *See In re* ACandS, Inc., 311 B.R. at 42.

158. *See In re* Combustion Eng'g, Inc., 391 F.3d 190, 201, 248–49 (3d Cir. 2004) ("Although pre-packaged bankruptcy may yet provide debtors and claimants with a vehicle for the general resolution of asbestos liability, we find the Combustion Engineering Plan defective for the reasons set forth.").

159. *See id.* at 242.

160. *See id.*

161. *Id.* at 243.

before the bankruptcy filing, but that retain a partially unpaid "stub" that entitles the holder of such claim to vote on the plan. Artificial impairment occurs where a plan is proposed containing an insignificant impairment of one class of claims, which class then votes in favor of the plan as an "impaired" class enabling a cramdown[162] under § 1129(a)(10).[163] Finding that the purpose of § 1129(a)(10) is to provide "some indicia of support for a plan of reorganization," the Third Circuit reasoned that voting creditors must have a "financial stake in its outcome" to have an incentive to monitor the bankruptcy proceeding.[164] The monitoring function of § 1129(a)(10) would be weakened, according to the court, by allowing stub claims where the holders were paid substantially all of the value of their claims pursuant to a prepetition trust.[165] The Third Circuit found that the holders of the stub claims, some receiving up to ninety-five percent of the value of their claims in prepetition settlements, did not have the proper incentive to monitor and vote on Combustion Engineering's plan, but instead voted in favor of the plan because the prepetition payments they received were "conditioned, at least implicitly, on a subsequent vote in favor of the Plan."[166]

Issues of disparate treatment between current and future claimants and "artificial impairment" can be avoided by structuring a prepack so that all claims are paid from the court-approved trust established by the reorganization plan pursuant to § 524(g). Such a structure allows the bankruptcy court and the FCR to scrutinize all payments to be made to the asbestos claimants and thus adds to

162. "Cramdown" is the process by which a bankruptcy court can confirm a reorganization plan over the objection of impaired claim or interest holders. *See* 11 U.S.C. § 1129(b) (2000).

163. *See* § 1129(a)(10). While the Third Circuit in *Combustion Engineering* was concerned with impairment primarily in the context of §1129(a)(10), it is conceivable that impairment could arise in the context of the required votes under § 524(g)(2)(B)(ii)(IV)(bb), which provides that "a separate class or classes of the claimants whose claims are to be addressed by a trust described in clause (i) is established and votes, by at least 75 percent of those voting, in favor of the plan." *See also Combustion Eng'g*, 391 F.3d at 243. Under this scenario, a debtor could devise a plan whereby settling current claimants would retain "stub" claims in order to meet the 75 percent voting requirement of §524(g). However, the non-settling claimants would argue that requisite support was achieved through a means that subverts the voting purpose of that section.

164. *Combustion Eng'g*, 391 F.3d at 243–44.

165. *See id.* at 244.

166. *Id.*

the transparency of the bankruptcy proceedings.[167] Moreover, an FCR typically will continue to represent the future claimants post-confirmation by monitoring the functioning of any § 524(g) trust established by the reorganization plan.[168] Most trust distribution procedures authorize the trustees of a § 524(g) trust to set an initial payment percentage and subsequently raise or lower the payment percentage regarding payments from the postpetition trust.[169] As part of the plan negotiations, an FCR usually obtains the right to consent to any such changes in the payment percentage. In this way, the FCR has an ability to monitor the amounts paid from the trust to ensure that over time the current and future claimants are treated similarly in the event that the total asbestos liability exceeds the projected amounts. Finally, paying claimants only pursuant to a confirmed reorganization plan and a single § 524(g) trust may eliminate the risk of costly litigation and further business disruptions that otherwise may occur in connection with efforts to recover amounts paid by the company to claimants in anticipation of the bankruptcy filing.

V. HALLIBURTON CASE STUDY: A POTENTIAL MODEL FOR FUTURE PREPACKAGED ASBESTOS BANKRUPTCIES

For the purpose of providing an illustration of an effective prepack,[170] Halliburton's bankruptcy case is summarized below. Following this summary, various characteristics of the Halliburton prepack are compared and contrasted to the benefits and concerns with asbestos prepacks discussed above.

167. In *Combustion Engineering*, the Third Circuit vacated a prepetition settlement with current claimants because it treated some current claimants better than other current and future claimants. *See id.* at 245, 248–49. The court noted that it might have allowed the settlement had all claimants, including future claimants, been adequately represented throughout the settlement negotiations. *See id.* at 245.

168. *See, e.g.*, Fourth Amended Joint Plan of Reorganization (as Modified) at ¶ 4.13.3, *In re* Fed.-Mogul Global Inc., No. 01-10578 (Bankr. D. Del. Nov. 5, 2007).

169. *See, e.g.*, *In re* Federal-Mogul Global, Inc., Trust Distribution Procedures, No. 01-10578 at ¶ 4.2 (Bankr. D. Del. June 5, 2007).

170. *See* Vairo, *supra* note 4, at 108 ("Perhaps the most significant prepack proceeding relying on 11 U.S.C. § 524(g) is that involving a subsidiary of Halliburton Company. Due to its complexity, the Halliburton plan, once court approved, could provide a template for the § 524(g) resolution of most of the asbestos BANKRUPTCY cases if Congress does not enact a bill in the near term.").

A. *Prepetition Negotiations and Events*

In a little over one year, Halliburton confirmed the prepackaged plan of its Mid-Valley and Dresser Industries, Inc. ("DII") subsidiaries.[171] Halliburton engaged an FCR before any of its assets were committed to the settling claimants.[172] Before agreeing to take on the role, the prepetition FCR carefully investigated Halliburton and interviewed the debtor's representatives in order to determine whether the debtor was prepared to negotiate in good faith to resolve its present and future asbestos liabilities.[173] Satisfied with Halliburton's intentions, the FCR executed an engagement letter with Halliburton.[174]

Several terms and conditions of the engagement letter between Halliburton and the FCR reflected the FCR's fiduciary duties owed to future claimants. For instance, the engagement letter allowed the FCR to hire legal counsel and financial advisors and provided that Halliburton would compensate them.[175] The engagement letter also provided that, notwithstanding the obligation of Halliburton to pay the fees of the FCR and his professionals, "the parties understand and acknowledge that the FCR's sole responsibility and loyalty is to the class of future asbestos personal injury claimants."[176] As an assurance to the FCR that the negotiations would proceed in good faith, Halliburton provided the FCR with the ability to terminate his role as FCR if, in his sole discretion, negotiations were not progressing reasonably and that the FCR and his professionals would still be entitled to fees already earned prior to the FCR's notice of termination.[177] Finally, the engagement letter provided that Halliburton would indemnify the FCR for performing his services under the engagement letter.[178]

The cumulative effect of these provisions was to enable the FCR to represent future asbestos personal injury claimants zealously

171. *See In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. July 21, 2004) (amended order *nunc pro tunc*).

172. *See, e.g.*, *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. Feb. 18, 2004) (final order granting debtors' application to appoint legal representative for purposes of sections 105 and 524(g) of the Bankruptcy Code).

173. *See* Transcript of Hearing at 106–07, *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. May 10, 2004) (testimony of Eric Green).

174. *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. Dec. 11. 2003) (application for an order appointing a legal representative for purposes of sections 105 and 524(g) of the Bankruptcy Code; Exhibit B).

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

in prepetition negotiations with Halliburton. If Halliburton refused to negotiate in good faith, the FCR could exercise his right to terminate his services, collect all amounts owed, and still be indemnified from possible claims resulting from the aborted prepetition negotiations.[179] Likewise, the same provisions ensured that Halliburton would negotiate in good faith lest it arrive in the bankruptcy court without the support of a legitimate FCR. Additionally, Halliburton would still owe the FCR any fees and amounts due and still face the expense and uncertainty inherent in a "free fall" asbestos bankruptcy case. As a result, Halliburton had multiple incentives to negotiate in good faith.

The FCR retained professionals to estimate Halliburton's future asbestos liabilities and past settlement history and to analyze Halliburton's capital structure. The FCR's professionals also monitored Halliburton's ongoing business operations, analyzed its potential insurance coverage, and identified all other relevant considerations to Halliburton's ability to fund a § 524(g) trust.[180] While the FCR's advisors were still conducting due diligence, the FCR resisted pressure by Halliburton and the current claimants to begin negotiations.[181]

Halliburton's first offer to the FCR was relatively low—one billion dollars paid over fifty years (present value of approximately $260 million).[182] Likewise, Halliburton initially balked at the FCR's negotiating demand that the § 524(g) trust be funded by substantial holdings of Halliburton stock.[183] The FCR believed that the

179. In the Halliburton case, the FCR retained the right to terminate his services prepetition. *Id.* ("Mr. Green reserves the right to terminate his and his professionals employment prior to the filing of reorganization proceedings if, in Mr. Green's sole judgment, the negotiation of a prepacked plan of reorganization is not progressing reasonably. Any such termination will not affect DII's obligation to pay any fees and expenses of Mr. Green or his professionals earned prior to notice of termination.").

180. *See Mid-Valley Findings*, *supra* note 26, at 15 ("In connection with the negotiation process, the Debtors responded to due diligence requests from the Asbestos Committee and the Legal Representative regarding (a) the business affairs of the Debtors and their relationships with affiliates, including historical financial statements, affiliate transaction documentation, public financial disclosures, SEC filings, third-party valuation reports, environmental reviews and other documents, (b) the historical asbestos and silica litigation against the Debtors, and (c) the feasibility of a plan of reorganization.").

181. *See id.* at 15–16.

182. *See* Transcript of Hearing, *supra* note 173, at 111.

183. *See id.* at 112 ("[Halliburton's] view was they were paying so much to take care of their asbestos problem, they weren't about, after doing that, to give up then the equity value in the company on top of that. So, stock in Halliburton was a nonstarter for most of the negotiations.").

future claimants would greatly benefit from the price appreciation of the Halliburton stock when the asbestos overhang was removed from the stock by a channeling injunction.[184] It took some time before Halliburton was willing to meet the FCR's demand.[185] After a period of intense negotiations, however, Halliburton eventually agreed to contribute 59.5 million shares to the trust.[186]

In December 2002, the FCR, Halliburton, and the current claimants entered into a term sheet that formed the basis of the subsequent prepack reorganization plan.[187] Under the plan, Halliburton agreed to contribute $2.66 billion in cash, 59.5 million shares of Halliburton stock, a contingent right to $700 million in insurance recoveries if Halliburton's recoveries exceeded $2.3 billion dollars, and a promissory note of $30.7 million dollars issued by DII and guaranteed by Hessy, DII's parent, and backed by a pledge of DII's stock.[188]

The cash paid by Halliburton largely went to pay existing settlements with claimants.[189] The FCR's financial advisors projected that the present value of future liabilities amounted to $1.8 billion dollars—$1.6 billion in payouts to future claims and $200 million in administrative expenses.[190] When the parties initially struck the deal, Halliburton's stock traded at about nineteen dollars per share—representing $1.1 billion for the trust's holdings.[191] By the time of the confirmation hearing, however, Halliburton's stock

184. *See id.* at 113 ("[I]t became clear to me that the only way they were going to have adequate assets to fund the future claims would be through stock of Halliburton, and not only would that stock provide obvious value, but it would provide an upside potential to claimants too, which if it could be captured because the value of the stock of Halliburton moved upwards as part of its resolution of its asbestos liabilities, that value could be captured for the future claimants . . . .").

185. *See id.* at 111–13.

186. *See Mid-Valley Findings*, *supra* note 26, at 16 ("During the course of negotiations, the Legal Representative pushed vigorously for an alternative structure that called for Halliburton equity to be substituted for a portion of the proposed note. Because Halliburton's equity is publicly traded and reflects the value of the entire Halliburton corporate family, the Legal Representative strongly believed that such a structure would maximize the benefit to future claimants by providing greater liquidity for the trust and by making the trust less dependent solely on the long-term performance of the Debtors. After several rounds of negotiations, Halliburton and the Debtors ultimately agreed to this structure.").

187. *See id.*

188. *See id.* at 18.

189. *See id.* ("[T]he Asbestos PI Trust will be funded by . . . cash contributions in an amount sufficient to pay Qualifying Settled Asbestos PI Trust Claims pursuant to the Plan . . . .").

190. *See* Transcript of Hearing, *supra* note 173, at 118.

191. *See id.*

traded at approximately thirty dollars per share—representing $1.8 billion for the trust's holdings.[192] On March 23, 2005, the trust diversified its holdings by selling all of Halliburton's stock for $2.5 billion ($42.50 per share) in one of the largest-ever secondary stock offerings.[193] Halliburton's stock rose in value as the prospects of the channeling injunction became more likely. As a result and as the FCR had projected, the future claimants benefited substantially by the appreciation of the 59.5 million shares held by the trust.[194] As a result of the successful reorganization and channeling injunction, the "economic pie" increased in size and everyone's piece got bigger (including the future claimants' and the debtor's).

With the stock sale proceeds of approximately $2.5 billion (exceeding projected liabilities by $700 million), there is a high probability that the trust will be able to pay future asbestos personal injury claimants 100% of the scheduled value of their claims into the future. [195] The Halliburton trust will be fully capable of meeting future claims completely independent of the future success or failure of the reorganized debtor, which diversification is itself a benefit to the future claimants. Additionally, future claimants will be able to obtain compensation without having to resort to time-consuming and costly litigation, another benefit offered by the trust to future claimants.

B. Prepack Filing and Post-Petition Events

Halliburton filed its prepackaged reorganization plan on December 16, 2003.[196] The bankruptcy court appointed the prepetition FCR, finding that he had "no prior association with the

192. *See id.*

193. On March 23, 2005, the trust's Halliburton shares were sold for $2,481,983,000, net of fees and other charges of $46,767,000. *See* Notice of Filing of the DII Indus. LLC Asbestos PI Trust's Annual Report for the Year Ending December 31, 2006, Exhibit 1.A at 8, *In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. Apr. 30, 2007); *see also* Len Boselovic, *Local CPA Oversees Asbestos Trust Fund*, PITTSBURGH POST-GAZETTE, Mar. 27, 2005, at C.1.

194. *See Mid-Valley Findings*, *supra* note 26, at 16–17 ("With the announcement of the term sheet, Halliburton's stature in the financial and capital markets improved and, as it became more apparent to the markets that a global settlement actually might be realized, Halliburton's ability to access the markets also improved.").

195. *See* Transcript of Hearing, *supra* note 173, at 118 ("[W]e think we'll be able to have [a] 100 percent plan because the estimates of the value of the future claims . . . is $1.8 billion, and that includes $200 million for administrative expenses over the life of the trust.").

196. *See Mid-Valley Findings*, *supra* note 26, at 4.

Debtors, Halliburton, or any of their subsidiaries or affiliates."[197] During the confirmation hearing process, the bankruptcy court found that the prepetition negotiations were "at arms' length and that all parties acted in good faith and were adequately represented."[198] The bankruptcy court also found that the reorganization plan complied with the applicable Code requirements including those of § 524(g). [199] The bankruptcy court confirmed Halliburton's reorganization plan on July 21, 2004, approximately eight months after filing.[200]

CONCLUSION

Halliburton's successful prepack demonstrates that prepacks remain a viable, robust solution to resolving a company's asbestos liabilities. Aside from maximizing the recovery available to asbestos claimants, prepacks can "increase the pie" for all stakeholders by reducing the time, disruption, and costs experienced inside of bankruptcy. Prepacks are most effective when a company chooses an FCR as soon as possible and when the FCR is involved in negotiations before asbestos liabilities undermine the value of a company's business. An FCR can maximize the recoveries of future claimants by aggressively negotiating a prepack with the company, but also by cooperating with the company when it makes economic sense to do so. While it is initially true that the interests of future claimants often are directly adverse to the debtor, once a deal has been struck the future claimants then become interested in the confirmation of the plan that embodied the deal—an interest shared with the debtor and other plan proponents.

197. *Id.* at 13.

198. *Id.* at 17.

199. *See id.* at 48–49.

200. *See In re* Mid-Valley, Inc., No. 03-35592 (Bankr. W.D. Pa. July 21, 2004) (amended order *nunc pro tunc*); *see also In re* Mid-Valley, Inc., No. 04-295 (Bankr. W.D. Pa. July 26, 2004) (order affirming order confirming plan of reorganization).