

Mid-Atlantic Bankruptcy Workshop 2021

The Increasing Use of Chapter 11 to Resolve Sexual Abuse Scandals

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ABI Mid-Atlantic Bankruptcy Workshop

August 6, 2021

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Materials and Discussion Disclaimer

Many of the presenters involved in this panel may be involved in ongoing cases in different roles. The topics discussed in this outline, and the issues raised in our presentation, are presented for academic purposes only and do not reflect the views of the attorneys involved, their law firms, or clients they may represent in ongoing pending matters.









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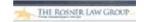
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I. The Tension Caused by Using a Financial Reorganization Tool to Resolve Highly Emotional Personal Injury Claims









New Trend for Chapter 11 Reorganization

- Chapter 11 is often thought of as a means by which a financially distressed entity can restructure its debt and reduce its financial obligations.
- The majority of diocesan bankruptcies have been filed primarily to address mass sex abuse tort claims filed against these dioceses. But for the potential liability for sex abuse claims, many of such diocese debtors would otherwise be financially sound. <u>See</u>, <u>e.g.</u>, David A. Skeel, Jr., Avoiding Moral Bankruptcy, 44 B.C. L. REV. 1181, 1181-86 (2003).
- Prior to the diocesan bankruptcy filings, the chapter 11 process had become an increasingly popular mechanism to address mass tort litigation, such as in the case of asbestos company bankruptcy filings. <u>See, e.g., In re Johns-Manville Corporation</u>, Case No. 82-11656 (S.D.N.Y. August 26, 1982).









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Sexual Abuse Bankruptcy Cases

- Although there are distinctions between chapter 11 cases filed to address mass sex abuse tort claims and typical commercial cases, there can be financial and procedural reasons for chapter 11 filings under these circumstances, including:
 - Avoiding a race to the courthouse,
 - More equitable treatment of claims and avoidance of early claims being paid more than late filed claims,
 - · Pooling of resources to address claims and insurance litigation, and
 - Permitting the organization to carry on its charitable mission.









Diocesan Bankruptcy Proceedings

- Diocesan bankruptcy proceedings are unique and distinct from other mass tort bankruptcy cases, and other chapter 11 bankruptcy cases in general, in a number of ways.
- Emotional and sensitive nature of the claims: The majority of creditors are sexual abuse survivors, which results in highly sensitive and emotionally charged proceedings.
 - The typical chapter 11 creditor seeks the repayment of money owed to it by the
 debtor, whereas sexual abuse survivors seek justice and compensation for deeply
 personal crimes committed against them. Bankruptcy, however, is not necessarily
 designed to provide justice but is instead designed to provide relief based on
 financial wrongs.
 - Due to the religious and moral issues involved in the diocesan cases, diocesan
 debtors face higher scrutiny from creditors and the media, who may be more likely
 to view the debtor as shirking its moral responsibilities through chapter 11.
- Allowing a diocese to carry on its charitable religious purpose is a long-term goal of these cases









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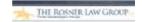
Management of the Debtor and Conflicts of Interest

- The debtor-in-possession has a fiduciary duty to the debtor's estate, but the bishop of the diocese also has a religious duty to the church and its members.
- These dueling duties can create obvious conflicts of interest, which also may be present in other chapter 11 cases of not for profit and charitable institutions.









Unique Role of Parishioners

- Parishioners are not necessarily creditors, but they are also not "shareholders" like in a corporation.
- However, they are clearly stakeholders.









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Property of the Estate Issues

- Due to the intersection between canon law (which typically views diocesan assets separately from parish assets) and secular law (which does not necessarily view such assets separately, depending upon organizational structures), there have been significant battles over what constitutes property of the estate, along with a number of fraudulent transfer actions involving non-debtor parishes and other charitable trusts, wherein diocesan debtors have been alleged to have transferred millions of dollars' worth of assets in order to shield themselves from liability.
- See, e.g., Comm. of Tort Litigants v. Cath. Diocese of Spokane, No. CV-05-0274-JLQ, 2006 WL 211792 (E.D. Wash. Jan. 24, 2006) (finding that tort claimants' committee had standing to challenge the debtor's characterization of parish churches, schools, and cemeteries property);
- See also In re Roman Cath. Bishop of Great Falls, Montana, 584 B.R. 335 (Bankr. D. Mont. 2018) (same).









■ Religious Freedom Issues

Scholars have also noted that there are a number of issues involving religious freedom and the Free Exercise Clause of the First Amendment that put these cases at odds with some aspects of the chapter 11 process, including, among other things, the appointment of a chapter 11 trustee. <u>See</u> Jonathan C. Lipson, When Churches Fail: The Diocesan Debtor Dilemmas. 79 S. Cal. L. Rev. 363, 365-366 (2006).









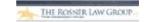
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II. Sexual Abuse Bankruptcy Cases and Stresses on the Bankruptcy Code









Claims Bar Date

Bankruptcy Rule 3003(c)(3).

The court shall fix and for cause shown may extend the time within which proofs of claim or interest may be filed. Notwithstanding the expiration of such time, a proof of claim may be filed to the extent and under the conditions stated in Rule 3002(c)(2), (c)(3), (c)(4), and (c)(6).









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Claims Bar Date in Sexual Abuse Bankruptcy Cases

- New state legislation provides "Revival Window" for child victims.
 - Ex: New York Child Victims Act, S7082/A9036; New Jersey Child Victims Act, N.J. S. 477.
- Eighteen states and Washington D.C. have revived previously expired statutes of limitations for a limited period, including:
 - Michigan (claims against doctors only);
 - Georgia, Massachusetts and Rhode Island (claims against perpetrators only);
 - Arizona, Connecticut, Minnesota, Montana, North Carolina, Oregon, Washington D.C. and West Virginia (revival window or for a specified age range against perpetrators and some others)
 - California, Delaware, Hawaii, New Jersey, and New York (revival window for 2 or more years or for a specified age range against all defendants)
 - Guam and Vermont (permanently open revival window for all defendants)









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Claims Bar Date in Sexual Abuse Bankruptcy Cases

- The Roman Catholic Diocese of Rockville Centre, New York
 - General claims bar date of March 30, 2021, while the sexual abuse claimants bar date was set for August 14, 2021.
 - · Coterminous with New York's statute of limitations.
- The Diocese of Buffalo, NY
 - · Claims bar date of August 14, 2021.
 - Coterminous with New York's statute of limitations.
- The Diocese of Camden, New Jersey
 - Claims bar date of June 30, 2021.
 - New Jersey's statute of limitations set a November 30, 2021 deadline.









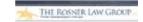
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Absolute Priority Rule

- Provides that equity owners cannot retain any property unless the plan provides for payment in full to any class of unsecured creditors that does not accept the plan.
- Courts have recognized a "new value exception" permitting equity holders to retain property if an adequate capital contribution in the form of money or money's worth is given.







Nonprofit Debtors and the Absolute Priority Rule

- Courts are inconsistent in the application of the absolute priority rule to nonprofit debtors, where there are no equity interests.
- Many of the cases lack any analysis of the retention of going-concern value by directors, managers, members, or the nonprofit debtor.
- The Seventh Circuit has provided guidance on three components of an equity interest.
 - Control;
 - · The right to share in profits; and
 - · Ownership of corporate assets.
 - In re Wabash Valley Power Assoc. Inc., 72 F.3d 1305, 1309 (7th Cir. 1996).









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Nonconsensual Third-Party Releases

- Section 524 of the Bankruptcy Code releases only the debtor. Courts have not adopted a single standard to approve such releases.
- The single point of agreement is that Third-party releases are approved only in "extraordinary cases." <u>In re Continental Airlines</u>, 203 F.3d 203, 212 (3d Cir. 2000); <u>In re Dow Corning Corp.</u>, 280 F.3d 648, 658 (6th Cir. 2002) (Such injunctions are a dramatic measure to be used cautiously); <u>In re Metromedia Fiber Network, Inc.</u>, 416 F.3d 136 (2d Cir. 2005) ("a release is proper only in rare cases").









■ Third-Party Release Standard Samples

Third Circuit

 Has not created a final standard, but <u>Continental</u> established a baseline standard that specific factual findings must be made that the releases are both fair and necessary to the proposed plan. 203 F.3d at 214. Most courts adhere to this minimum guiding principle. 20 J. Bankr. L. 7 Prac. 4 Art. 7

Other Circuits

- Releases must be "essential to the reorganization. In re Metromedia <u>Fiber Network, Inc.</u>, 416 F.3d 136, 141 (2d. Cir. 2005) (citing (<u>In re</u> <u>Drexel Burnham Lambert Group, Inc.</u>), 960.F.2d 285, 293 (2d Cir. 1992).
- In re Dow Corning Corp., 280 F. 3d 648, 658 (6th Cir. 2002) developed a 7-factor test, most of which are covered here.

Most Prevalent Standard

- the identity of interest between the debtor and nondebtor such that a suit against the nondebtor will deplete the estate's resources;
- 2) a substantial contribution to the plan by the nondebtor;
- the necessity of the release to the reorganization;
- the overwhelming acceptance of the plan and release by creditors and interest holders; and
- the payment of all or substantially all of the claims of the creditors and interest holders under the plan.
- See <u>In re: One2One Commc'ns, LLC</u>, 2016 WL 3398580, at *6 (D.N.J. June 14, 2016) (citing <u>In re Master Mortgage Inv. Fund, Inc.</u>, 168 B.R. 930,937 (Bankr. W.D. Mo. 1994))









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Propriety of Third-Party Releases

- "Substantial contribution" is fact-specific.
- Two factors help determine the fairness of the consideration paid by the recipient of a third-party release.
 - 1) An analysis of the reasonableness of the released parties' contributions considers their ability to pay.
 - See In re HWA Props., 544 B.R. 231, 241 (Bankr. M.D. Fla. 2016); In re Mahoney Hawkes, LLP, 289 B.R. 285, 302 (Bankr. D. Mass. 2002).
 - 2) The released parties' contributions must bear some relationship to the value of the potential claims against them.
 - In re W.R. Grace & Co., 475 B.R. 34, 106 (D. Del. 2012), aff'd sub nom. In re WR Grace & Co., 729 F.3d 332 (3d Cir. 2013).
- Due process requires that claimants receive compensation that stems from the actual value of the property being taken from them.
 - <u>See In re Aegean Marine Petroleum Network Inc.</u>, 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019).









III. The Increasing Use Of Mediation To Resolve Sexual Abuse Cases In Bankruptcy









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Bankruptcy Mediation, Generally

- Mediation allows parties to avoid the unpredictability and expense of litigation, especially where litigation would be drawn-out, expensive and highly fact-driven.
- Mediation is not specifically addressed in the Bankruptcy Code or Bankruptcy Rules, but courts often rely on local rules providing for mediation. Prior to local rules addressing mediation, courts relied on provisions concerning the appointment of an examiner pursuant to section 1104 of the Bankruptcy Code or section 105(a) of the Bankruptcy Code.
 - Bankruptcy Courts for the Northern, Southern and Eastern Districts of New York have included a provision authorizing mediation as part of their Local Rules.
 - Local Bankruptcy Rule 9019-2(a) for the District of New Jersey provides: "Every
 adversary proceeding will be referred to mediation after the filing of the initial answer to
 the adversary complaint, except [when a specified exception applies]"; and "A contested
 matter . . . may also be referred to mediation . . . by the court at a status conference or
 hearing."
 - Local Bankruptcy Rule 9019-5(a) for the District of Delaware provides: "Except as may
 be otherwise ordered by the Court, all adversary proceedings filed in a chapter 11 case
 and, in all other cases, all adversaries that include a claim for relief to avoid a
 preferential transfer (11 U.S.C. § 547 and, if applicable, § 550) shall be referred to
 mandatory mediation."









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Bankruptcy Mediation, Generally

- Mediation in bankruptcy will ideally create a pool of assets to satisfy claims, and provides a clear alternative to a "race to the courthouse" scenario that bankruptcy seeks to avoid.
- Mediation can help resolve complex insurance coverage disputes such as late notice, number of occurrences, and "expected or intended" issues.
- Mediation can be especially relevant in bankruptcy cases with significant tort claims, which can't be addressed directly by bankruptcy courts. 28 U.S.C. 157(b)(5) provides:

"The district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending."









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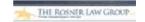
Historical Resolution of Claims in Mass Tort Cases

- Resolution of far-ranging, numerous tort claims through the bankruptcy process began with asbestos litigation. Over 700,000 asbestos personal injury and wrongful death claims were filed against over 80 asbestos firms from the mid-1980s through the early 2000s (See RAND INSTITUTE, ASBESTOS LITIGATION, at xxiv (2005)).
- Since that time, non-asbestos mass tort cases have charted similar paths toward a global resolution for claim resolution
- Some form of mediation or active judicial participation in the settlement of issues between the various constituents has been used to resolve a diverse collection of mass tort issues:
 - Pharmaceuticals (Mallinckrodt PLC, Purdue Pharma)
 - Silicon implant cases (Dow Corning)
 - Dalkon Shield (A.H. Robins, Inc.)









Pros and Cons of Bankruptcy Mediation in Abuse Cases

- The automatic stay creates a pause in litigation that may allow for a global resolution.
- Claims have common threshold liability issues and differences in claims can be addressed through a claims administration process.
- Avoid expensive insurance coverage litigation involving numerous insurers across many coverage years.

However:

- Abuse claimants seeking jury trials and individual court actions – due process concerns.
- Aggregating claims may create a pressure to settle for more meritorious claims while creating a low bar to asserting claims and create a danger of false or unsupportable claims.









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Parties to Mediation – Who should be at the negotiating table?

- The concept of mediation between all of the parties at the same time, or several subsets of the groups below (sometimes referred to as "co-mediation") should be carefully considered.
- Mediation should include:
 - Debtor/Diocese
 - Official Committee of Unsecured Creditors
 - The abuse claimant committee, if separately organized.
 - Insurers
 - Parishes or other non-debtor entities named in abuse claims.









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Timing of Mediation

- Prior to bankruptcy as part of a pre-arranged or prepack plan.
- During the initial stages of the case, to facilitate a stay of actions against related parties and additional insureds.
- After the claims bar date when the universe of claims is known.
- At the plan stage, to address releases, the treatment of non-debtor entities and to determine procedures for claims administration.









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What issues can be settled through mediation?

- Availability of insurance proceeds.
- Total amount available for distribution to claimants.
- Clawback actions.
- Property of the estate issues.
- Abuse claim administration procedure.
- Parish and other entity contribution.
- Non-debtor releases.









Consequences of the Failure of Mediation

- Parties may seek to have the Court estimate claims for plan voting and other purposes. <u>See, e.g., In re Eagle-Picher Indus., Inc.</u>, 189 B.R. 681, 687–88 (Bankr. S.D. Ohio 1995).
- Some claimants may seek relief to allow them to litigate individual claims (most recently, in the chapter 11 case <u>In re The Diocese of Rochester</u>, Bankr. W.D.N.Y. 19-20905).
- Drawn-out insurance litigation for each policy year may create grossly unequal outcomes for claimants.









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IV. Survivors' Rights to a Jury to Resolve Their Claims









Right to Jury Trial

- The Seventh Amendment to the United States Constitution provides that parties litigating in federal court have the right to a trial by jury in civil cases.
- Congress intended to preserve the jury trial right of the personal injury tort claimants in bankruptcy:
 - The Bankruptcy Code "do[es] not affect any right to trial by jury that an individual
 has under applicable nonbankruptcy law with regard to a personal injury or
 wrongful death tort claim." 28 U.S.C. § 1411(a) (emphasis added).









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Conundrum: Filing a Proof of Claim May Result in Waiver of Right to Jury Trial

- The right to a jury trial is subject to being waived and, in the context of a bankruptcy case, may be waived unintentionally as a result of filing a proof of claim.
- The Supreme Court has held, by filing a proof of claim, a creditor triggers the process of "allowance and disallowance of claims" and therefore submits itself to the equitable jurisdiction of the bankruptcy court and waives its right to a jury trial. See, e.g., Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, (1989); Langenkamp v. Culp, 498 U.S. 42 (1990); see also Travellers Int'l AG v. Robinson, 982 F.2d 96, 100 (3d Cir. 1992).









Application of <u>Granfinanciera</u> and <u>Langenkamp</u> Involving Tort Claims

- Majority view:
 - Filing of proof of claim waives a tort claimant's right to jury trial.
 - See, e.g., In re Smith, 389
 B.R. 902, 916 (Bankr. D. Nev. 2008); Lang v. Lang (In re Lang), 166 B.R. 964, 967 (D. Utah 1994) (court found husband had filed an "informal" proof of claim and therefore had waived his right to jury trial for his tort claim against wife); In re Jim Walter Res., 172 B.R. 380, 383 (Bankr. M.D. Fla. 1994).

Minority View:

- Filing of proof of claim does not waive a tort claimant's right to jury trial.
- <u>See In re G-I Holdings, Inc.</u>, 323 B.R. 583, 626 (Bankr. D.N.J. 2005). Court declined to apply <u>Langenkamp</u> because:
 - <u>Langenkamp</u> "did not deal with personal injury tort or wrongful death claimants, but rather with garden-variety creditors of a bankruptcy estate," and
 - Congress intended different treatment of personal injury tort claimants from other creditors when it enacted 28 U.S.C. § 157(b)(2)(B), 157(b)(5) and 1411(a) and applying <u>Langenkamp</u> to tort claims would "eviscerate and nullify these provisions specifically enacted by Congress to preserve the jury trial rights of personal injury tort and wrongful death claimants"









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Waiver of Right to Jury Trial (Cont.)

- The creditor cannot preserve its right to jury trial through the inclusion of protective language in a proof of claim. <u>See</u>, <u>e.g.</u>, <u>Schmidt v. AAF Players LLC</u> (<u>In re Legendary Field Exhibitions LLC</u>), 19-05053 (Bankr. W.D. Tex. Jan. 10, 2020).
 - The creditor's proof of claim included a reservation of rights, which stated that "filing of this proof of claim is not and shall not be deemed or construed as ... a waiver or release of the Plaintiffs' rights to a trial by jury."
 - Bankruptcy Court found it irrelevant that the claimants had purported, through
 inclusion of protective language in their proof of claim, to reserve their right to a jury
 trial, concluding: "Even if a creditor attempts to couch its claim in protective
 language reserving the right to a jury trial, such protective language is not binding
 on the Court; rather, the Court is bound by <u>Langenkamp</u> and <u>Granfinanciera</u>, which
 found that filing a proof of claim results in waiver of the right to jury trial."









Waiver of Right to Jury Trial (Cont.)

- The creditors are left with the difficult question to either:
 - waive their right to a jury trial by filing a proof of claim, or
 - forgo filing a proof of claim but risk the loss of their right to participate in the plan process and distribution of the bankruptcy estate









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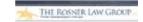
Another Complication: Effect of Non-Consensual Third Party Releases

- 28 U.S.C. § 1141(a) was intended to afford tort victims the ability to sue debtors and other third parties after the bankruptcy proceedings are concluded.
- However, § 1141(a) may be rendered meaningless when the bankruptcy court confirms a plan of reorganization/liquidation that approves nonconsensual third party releases without the ability to opt out such release provisions.
 - Example: The Weinstein Company Holdings, LLC, et al., Case No. 18-10601 (MFW), (Bankr. D. Del.) over the objection of certain sexual misconduct claimants, the bankruptcy court approved a plan or liquidation containing certain non-consensual third party releases. The plan does not allow holders of sexual misconduct claims to opt-out of the releases against third parties (except for Harvey Weinstein).









Faculty

Zhao (Ruby) Liu is an attorney with the Rosner Law Group LLC in Wilmington, Del., where she focuses her practice on corporate bankruptcy and business litigation. She represents chapter 11 debtors, creditors' committees, liquidating trustees, secured and unsecured creditors, officers and directors, debtor-in-possession lenders, intellectual property licensors, acquirers of assets and investors. Ms. Liu also assists companies and creditors in out-of-court workout and restructuring efforts. She is fluent in mandarin Chinese and has a specialty practice with the firm frequently representing Chinese vendors, investment bankers and other Chinese entities in connection with chapter 11 bankruptcies, as well as business litigation in the state and federal courts in the state of Delaware. In addition, she also issues Delaware third-party opinions in connection with securities offerings of companies in China. Ms. Liu received her J.D. from the Widener University Commonwealth Law School in 2016, where she was a senior editor of the *Widener Journal of Law, Economics and Race*, a member of the Moot Court Honor Society, and a research assistant to former ABI Resident Scholar Prof. Juliet Moringiello.

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