



A POTENTIAL PATH FOR THE DOJ'S U.S. TRUSTEE PROGRAM TO CHALLENGE FRAUD IN ASBESTOS BANKRUPTCY TRUSTS

by Anthony Grossi

The U.S. Trustee program is a component of the U.S. Department of Justice which, among other things, protects the integrity of the overall bankruptcy system. The U.S. Trustee's office has a storied history of discharging this significant responsibility vigorously, expertly, and thoroughly.

One area where its expertise and independence is sorely needed, but on which it has felt restrained from acting, is oversight of asbestos bankruptcy trusts established after the confirmation of a Chapter 11 plan. This LEGAL OPINION LETTER briefly explains the nature and history of asbestos bankruptcy trusts, the significant indicia of fraud surrounding the administration of these trusts, the potential oversight by the U.S. Trustee, and recent developments that could forge a path for U.S. Trustee program involvement.

Over the past several years, the U.S. House Judiciary Committee conducted several oversight hearings and approved legislation to enhance the transparency of the asbestos bankruptcy trust system, which then passed the House of Representatives during two separate legislative sessions. Ultimately, the Senate did not consider these reforms and the legislation lapsed upon the conclusion of each congressional session. The hearings did, however, raise awareness of the harm fraud in bankruptcy trusts causes.¹

The most common type of fraud occurs when parties who assert claims alleging a particular harm or injury in one forum—either in state court or against an established bankruptcy trust—turn around and file an additional claim in another forum alleging a different, often conflicting, set of facts. What results is the misallocation of finite dollars to satisfy these fraudulent claims. Funds are then unavailable to legitimate victims who assert claims against depleted or exhausted asbestos trust funds. The quantum of this potential fraudulent activity could be enormous. Indeed, in a single year, asbestos bankruptcy trusts remitted over \$4 billion to claimants. Even if only 1% of these claims were fraudulent, that is \$40 million taken from deserving victims.

This problem has not gone unnoticed. The *Wall Street Journal* has published several articles and op-eds detailing fraud within the asbestos bankruptcy trust system.² Certain state courts have issued decisions describing fraudulent activity.³ Testimony before Congress has documented the many instances of fraud.⁴

¹ See H. Rep. No. 115-18, at 12-14 (2017) (cataloguing fraud committed in the asbestos bankruptcy trust system including in the cases of *Kananian v. Lorillard Tobacco Co.*, *Mary A Robeson et al. v Amatek, Inc. et al.*, *Montgomery v. Foster Wheeler*, and *In re Garlock Sealing Techs. LLC*).

² See, e.g., Dionne Searcey and Rob Barry, *As Asbestos Claims Rise, So Do Fears About Fraud*, WALL ST. J., Mar. 11, 2013; *Busting the Asbestos Racket*, WALL ST. J., Feb. 7, 2014.

³ See, e.g., *Montgomery v. Foster Wheeler*, Case No. 09C-11-215 ASB, Pretrial Hrg. Trans. (Del. Super. Ct. Nov. 7, 2011).

⁴ See, e.g., *How Fraud and Abuse in the Asbestos Compensation System Affect Victims, Jobs, the Economy, and the Legal System: Hrg. Before the Subcommittee on the Constitution of the H. Comm. on the Judiciary*, 112th Cong. (2011) at 94-95, 103-05 (written testimony of James Stengel).

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And a recent bankruptcy case in North Carolina has uncovered serial fraud.⁵

The U.S. Trustee's office similarly has acknowledged the potential for fraud within the asbestos bankruptcy trust system. The Director of the U.S. Trustee program, Clifford J. White has stated "[t]here is a general lack of transparency in the operation and oversight of post-confirmation trusts, especially asbestos trusts. Among other things, there is a lack of reporting on the operations of such trusts and no clear recourse for stakeholders to challenge the claims review process or the administration of trust operations."⁶ Director White also testified that it was very clear for asbestos trusts that "there is no independent policeman, there is no watchdog ... neither the court nor the U.S. Trustee program have [sic] significant jurisdiction post-confirmation. So, when you don't have an independent review, then you run certain risks for abuse."⁷

The nature of asbestos bankruptcy trusts creates a substantial need for independent oversight. Lawyers representing the existing and potential claimants of a trust can designate the administrator. Accordingly, the administrators and the legal representatives assigned as monitors typically have perverse incentives that result in poor supervision, a characteristic oft-noted and detailed at length during congressional hearings.

Recent events may provide the U.S. Trustee program with a path to extending its general Chapter 11 oversight into post-confirmation asbestos bankruptcy trusts. In December 2016, the Bankruptcy Court for the District of Delaware rendered a decision in *In re Millennium Lab Holdings II, LLC* on a discovery request under Rule 2004 of the Federal Rules of Bankruptcy Procedure made by a trustee for a post-confirmation litigation trust.⁸ Certain parties subject to the discovery request objected, arguing, among other things, that the bankruptcy court did not have jurisdiction over the post-confirmation litigation trust and the proposed discovery request. The Delaware Bankruptcy Court disagreed and noted that "[t]he fact that this Rule 2004 Motion was filed post-confirmation does not alter this conclusion."⁹

The ruling is important for two reasons. First, it further establishes that the bankruptcy courts have continuing jurisdiction over actions related to post-confirmation trusts. Second, the discovery request under Rule 2004 is one tool that the U.S. Trustee's office could deploy to investigate whether fraud is being committed.

In lieu of an exhaustive review of all trust claims, which is beyond the U.S. Trustee program's resources, the office could examine selected asbestos bankruptcy trusts. That alone could have a meaningful impact on the overall trust system. Such oversight could be considered a component of the U.S. Trustee's statutory charge under 28 U.S.C. § 586(3)(F) to "notify[] the appropriate United States attorney of matters which relate to the occurrence of any action which may constitute a crime under the laws of the United States" Indeed, 20 state attorneys general recently wrote to U.S. Attorney General Jeff Sessions asking the Department of Justice to investigate and prosecute potential fraud in the asbestos bankruptcy trust system.¹⁰

The U.S. Trustee program is well-positioned to establish and exert their oversight authority over post-confirmation asbestos bankruptcy trusts. Given the historical and documented abuses perpetuated in the asbestos bankruptcy system, as well as the developments discussed above, the path is well-defined for the office to extend its oversight and impose the rule of law in a system where it is vitally needed.

⁵ *In re Garlock Sealing Technologies, LLC*, 504 B.R. 71 (Bankr. W.D. N.C. 2014).

⁶ *A Time to Reform: Oversight of the Activities of the Justice Department's Civil, Tax and Environment and Natural Resources Divisions and the U.S. Trustee Program: Hrg. Before the Subcomm. on Regulatory Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary*, 115th Cong. (2017).

⁷ *Ibid.*

⁸ 562 B.R. 614 (Bankr. D. Del. 2016).

⁹ *Id.* at 622.

¹⁰ Letter from Alabama Attorney General Steve Marshall, *et al.*, to Attorney General Jefferson B. Sessions, III (Nov. 6, 2017) (on file with the author).