

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE THE LOEWEN GROUP, INC.  
SECURITIES LITIGATION

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CIVIL ACTION

NO. 98-6740

O'NEILL, J.

MAY , 2001

MEMORANDUM

This action was placed in the Civil Suspense Docket on June 9, 1999 after defendants the Loewen Group, Inc. and certain of its subsidiaries' ("Loewen") filed for reorganization under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330. Before me now is lead plaintiffs' renewed motion to have the case removed from the Civil Suspense Docket so that they may proceed against certain officers and directors of Loewen who are individual non-debtor defendants in this action. The motion will be denied.

BACKGROUND

This matter was originally a series of purported securities class actions brought against Loewen, a publicly held company specializing in the operation of funeral homes and cemeteries, as well as a number of Loewen's individual officers and directors. The complaints essentially alleged that Loewen made inaccurate or incomplete disclosures regarding the financial condition of the company, and that certain individuals in their capacities as officers and directors of Loewen either did not correct these disclosures or deliberately falsified them. Specifically,

plaintiffs allege that the defendants misrepresented and/or failed to disclose that numerous new acquisitions had created a severe liquidity crisis for Loewen and that the defendants overpaid for the new acquisitions and then used accounting “gimmicks” to report artificially high profits. The actions were consolidated by Order dated April 14, 1999.

On June 1, 1999 Loewen filed for reorganization under Chapter 11 of the Bankruptcy Code. On June 9, 1999 I placed the actions in the Civil Suspense Docket. On July 7, 1999 plaintiffs moved to remove the actions from suspense in order to permit them to proceed against only the individual defendants. This motion was denied by Order dated November 9, 1999. Plaintiffs filed a motion for reconsideration on November 22, 1999. This motion was denied by Order dated December 10, 1999. On January 18, 2001 plaintiffs filed a renewed motion to remove the consolidated actions from the civil suspense docket in order to proceed against the individual “non-debtor” defendants. On March 8, 2001 I ordered plaintiffs to respond to defendants’ contention that the “debtor defendant” (i.e. Loewen) would be an indispensable party under Fed. R. Civ. P. 19 with the result that an action against the individual defendants could not proceed in its absence. The March 8, 2001 Order also directed Loewen to submit a letter brief describing the current status of its reorganization, including an estimate of how much longer its bankruptcy proceedings were likely to continue.

#### DISCUSSION

In Smith v. Dominion Bridge Corp, No. Civ. A 96-7580, 1999 WL 111465 (E.D. Pa. March 2, 1999), individual defendant officers and directors in a securities fraud case requested that the court stay proceedings against them in light of its decision to grant a stay of proceedings

against the corporate defendant because of a pending bankruptcy proceeding in Canada. The Smith court stated that neither the stay entered by the Canadian court nor the automatic stay provisions of 11 U.S.C. § 362(a) apply to non-bankrupt co-defendants except under certain “unusual circumstances.” These circumstances were held to exist when “there is such identity between the debtor and third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third party defendant will in effect be a judgment or finding against the debtor or where the protection of a stay is essential to the debtor’s reorganization efforts.” Smith, 1999 WL 111465 at \*4. Citing United Nat’l Ins. Co. v. Equipment Ins. Managers, No. Civ. A. 95-CV-0116, 1997 WL 241152 (E.D. Pa. May 6, 1997), the Smith court identified four factors to consider in determining whether a court should proceed without a party “whose absence from the litigation is compelled by other reasons”: (1) plaintiff’s interest in having a forum and whether or not plaintiff has a satisfactory alternative forum, (2) whether the defendants may wish to avoid multiple litigation or inconsistent relief or sole responsibility for liability they share with another, (3) the interest of the outsider whom it would have been desirable to join and the extent to which the judgment may, as a practical matter, impair or impede the absent party’s ability to protect his/her interest, and (4) the interest of the courts and the public in the complete, consistent and efficient settlement of controversies. Smith, 1999 WL 111465 at \*4.

With respect to the first factor this case has been placed in suspension. Plaintiffs retain this Court as a forum in which to bring their claims.

Factors two, three and four from United Nat’l Ins. also weigh in favor of denying plaintiffs’ motion. Plaintiffs maintain that circumstances have changed dramatically in recent

months and that the reasons that led to the denial of their previous requests to remove the case from suspension no longer exist. Plaintiffs cite In re First Central Financial Corp., 238 B.R. 9, 19 (Bankr. E.D.N.Y. 1999) which states: “Clearly, the underlying purpose behind embracing non-debtor officers and directors within the stay provided by § 362(a) is to suspend actions that pose a serious threat to a corporate debtor’s reorganization efforts.” Under the present circumstances, argue plaintiffs, allowing the case to move forward against individual officers and directors would allow whatever reorganization of Loewen remains to continue with minimal hardship to the company. In support of this assertion plaintiffs point to a number of factors: (1) if they are allowed to proceed against the individual non-debtor defendants they will not name Loewen or anyone who is currently an employee of Loewen as a defendant, and therefore the only burden on the company would involve responding to non-party discovery, (Pl.’s Mot. at 5); (2) on November 14, 2000 the Loewen Group announced that it had filed a reorganization plan with the Bankruptcy Court; (3) current Loewen CEO John S. Lacey recently stated: “[w]e are hopeful that the plan confirmation process will proceed expeditiously so that the ‘new Loewen’ may at the earliest practical opportunity emerge from Chapter 11/CCAA and commence normal day-to-day operations.” (Pl.’s Mot. at 3).

In response to my Order requesting an update with respect to the status of its bankruptcy proceeding Loewen states that it has “made significant progress since the Petition Date in restructuring [it’s] businesses and restoring them to profitability. Through the filing of the Plan and the Disclosure statement, the debtors also have made significant progress towards their emergence from Chapter 11 protection.” However Loewen also states that there is uncertainty as to the status of approximately \$1.1 billion of pre-petition indebtedness issued under “the

Collateral Trust Agreement” to which the company is a party. The dispute over the CTA is currently before a mediator and Loewen states that since it cannot predict the outcome of the CTA proceeding it cannot predict the extent to which it will delay its reorganization plan. Defendants assert that the Standing Order regarding the Civil Suspense Docket, §1(b), calls for the trial judge to monitor the status of the civil action in question and “transfer the case to his regular trial list as soon as the condition which required the transfer to the Civil Suspense Docket has been removed.” Since Loewen is still in bankruptcy, defendants contend that this condition remains unchanged and therefore the entire case should remain in suspense so that Loewen may concentrate on reorganization without being distracted by pending litigation.

The Smith court stated that an automatic stay granted to a bankrupt corporate defendant should be extended to the non-bankrupt co-defendants of the corporation where “there is such identity between the debtor and third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third party defendant will in effect be a judgment or finding against the debtor. . . or where the protection of a stay is essential to the debtor’s reorganization efforts.” Smith, 1999 WL 111465 at \*4 (emphasis added). Therefore, even if plaintiffs are correct and Loewen’s reorganization efforts are near completion, plaintiffs must still rebut defendants’ contention that a case cannot proceed against the individual defendants in Loewen’s absence because Loewen would be the real party in interest in any such action. I find that plaintiffs have not met this burden.

In Smith the court held that the corporate defendant would be unable to protect its interests adequately if the case were allowed to proceed against the individual defendants alone. Id. at \*5. The court based this determination on the fact that the individual defendants were

officers of the corporate defendant and the plaintiffs' claims against them arose out of the same factual basis. See id. The Smith court held that the corporation would face the possibility of collateral estoppel preventing it from litigating factual and legal issues critical to the plaintiffs' claims against it. Further, the court found that even the possibility that the corporation might have to indemnify the individual defendants in the event of an award against them would force the corporation to focus at least some of its efforts on the defense of these individuals to protect its interests, thereby distracting them from their reorganization efforts.

Similarly, in the case before me the misconduct alleged by plaintiffs relates entirely to activities performed by the individual defendants in their capacity as directors and officers of Loewen. In their letter responding to my Order dated March 8, 2001, plaintiffs quote an attorney for Loewen in support their contention that Loewen is not an indispensable party. According to plaintiffs, this attorney stated that Loewen's downfall "was in part because it became more interested in showing good revenues so that the capital markets would continue to throw money [at it]. Specifically, it ran into trouble when it expanded aggressively into cemeteries and booked the entire value of so-called 'pre-need' sales full of funeral and cemetery services even though payments were not in full." While providing a clear illustration of plaintiffs cause of action against the company, this quote also demonstrates that the plaintiffs themselves cannot meaningfully separate the actions of the company from the actions of its officers and directors. Loewen would be the real party in interest in any action against the individual non-debtor defendants. As defendants note, if plaintiffs' motion is granted, Loewen would risk being collaterally estopped from relitigating issues decided in favor of plaintiffs in any future action against the company. On the other hand if issues are decided in favor of the individual

defendants, there exists the possibility that substantially identical issues would be relitigated in a subsequent action by plaintiffs against Loewen. (Def. Loew. at 4). An action against the individual non-debtor defendants would risk unnecessary duplication of issues and inconsistent relief in any subsequent action by plaintiffs against Loewen, thereby undermining the interest of the courts in the complete, consistent and efficient settlement of controversies.

Further, many of the critical factual determinations to be made in an action against the individual defendants would entail detailed and burdensome discovery on the part of Loewen. For example, one of the main issues will be whether Loewen's prospectuses, earnings announcements, and submissions to the SEC were correct or incorrect. Contrary to plaintiffs assertions, even if neither Loewen nor any of its current employees would be named in the suit contemplated by plaintiffs it is difficult to imagine how a case against the individual non-debtor defendants could proceed without the company's substantial involvement.

Removal from the suspension docket seems particularly unnecessary since the company has filed for reorganization rather than liquidation and will eventually emerge from bankruptcy at which point plaintiffs may proceed with their suit against all defendants. Plaintiffs disagree, maintaining they will suffer considerable harm if the case is not immediately removed from suspension. They assert that since these actions were placed in suspension in June, 1999, Loewen has had almost two years to reorganize. Further, plaintiffs maintain that even if the individual defendants are removed from suspension they will in all likelihood move to dismiss the complaint, delaying discovery by another six months. Plaintiffs are concerned that over time witnesses and former Loewen employees will become more and more difficult to locate and may not remember events central to plaintiffs' case. (Pl.'s Mot. at 5 n.5, 6, 7). I find this argument

unpersuasive. As defendants point out, my Order of April 14, 1999 required that all documents relevant to plaintiffs' claim be preserved. In addition, much of the information relevant to plaintiffs' claim is being analyzed and filed by the Bankruptcy Court.

Plaintiffs also contend that indemnification no longer weighs in favor of suspension because such protection is not provided to the former officers and directors under the new reorganization plan and therefore Loewen need not be concerned about any potential award plaintiffs might win if the case is allowed to proceed against the individual defendants. Defendants assert in response that the plan is not yet final. However, I note that even if plaintiffs are correct and the individual defendants are not indemnified there remain the duplication, collateral estoppel and burdensome discovery problems that would be created for Loewen were I to allow an action against its former officers and directors to proceed.

Plaintiffs may not do indirectly what the bankruptcy laws prohibit them from doing directly; that is bring suit against a company in reorganization merely by substituting the officers and directors plaintiffs contend were responsible for the company's alleged misconduct.

An appropriate Order follows.

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NO. 98-6740

**ORDER**

AND NOW, this            day of May, 2001, in consideration of lead plaintiffs' renewed motion to remove the consolidated actions from the civil suspense docket and defendants' response thereto, it is ORDERED that the motion is DENIED. This action will remain in the Civil Suspense Docket.

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THOMAS N. O'NEILL, JR., J.