CLIENT ALERT

Recent Court Decisions Clarify When Asbestos Tort Claims Against Reorganized Debtors Are Effectively Enjoined

Mar.31.2020

Three recent court decisions address the scope and limits of bankruptcy injunctions barring future asbestos claims. The decisions – from the Second Circuit Court of Appeals, a Maryland bankruptcy court, and the Montana Supreme Court – underscore that (i) broad notice of proposed injunctions is critical and (ii) channeling injunctions under § 524(g) of the Bankruptcy Code apply only to liabilities that are derivative of the debtor's liabilities, not to a company's own liabilities. The lessons of these cases should also be applicable to bankruptcy cases involving tort claims other than asbestos claims.

***Marsh USA v. The Bogdan Law Firm (In re Johns-Manville Corp.)*, No. 1802531(l) (2d Cir. Feb. 19, 2020)**

In *Marsh USA v. The Bogdan Law Firm (In re Johns-Manville Corp.)*, the U.S. Court of Appeals for the Second Circuit considered whether tort claims against Marsh USA, an insurance broker, were barred by the asbestos channeling injunction entered in 1986 in the *Johns-Manville* bankruptcy. The court held that those 1986 orders – precursors to the channeling injunction now common in asbestos bankruptcies, authorized under § 524(g) of the Bankruptcy Code – channeled into the Manville Trust "all Johns-Manville related claims against settling insurers and insurance brokers (including Marsh)."

One claimant, Salvador Parra, Jr., asserted that his claims against Marsh should not be enjoined and channeled into the trust. He argued that the channeling injunction should not be enforceable against him because he had not received sufficient due process during the Manville bankruptcy proceeding. The bankruptcy court rejected Parra's argument, finding that the injunction was enforceable because Parra's interests were represented *in absentia* by the future claims representative (the FCR) appointed during the Manville bankruptcy. The district court reversed, but the Second Circuit reversed the district court in an unpublished decision, reinstating the bankruptcy court's ruling.

Parra argued that his claims against Marsh relating to its own conduct (which the court described as "in personam" claims, to distinguish them from claims against the debtor's property, the "res" of the bankruptcy estate) could not properly be channeled, although the injunction purported to do so. The Second Circuit noted that in 1985, during the original bankruptcy court proceedings, the FCR had argued that the injunction should be limited to claims arising from the contractual obligation of settling insurers to cover Johns-Manville's liability (which the court described as "in rem" claims). However, the bankruptcy court in 1986 rejected the FCR's argument and instead issued an injunction that applied to in personam as well as in rem claims. In the current appeal, the Second Circuit concluded that the FCR's advocacy 34 years earlier had provided Parra and other then-future claimants adequate representation, even though the bankruptcy court back in 1986 had rejected the FCR's arguments. The Second Circuit noted: "This is especially true as applied to the order enjoining claims against Marsh. Since Marsh did not issue any insurance policies, all foreseeable suits against it would necessarily be in personam. Because the record supports the conclusion that the FCR advocated for the exclusion of in personam claims to protect the interests of future claimants, the bankruptcy court did not clearly err in concluding that the FCR provided Parra with adequate representation on that score."

The Second Circuit also ruled that the notice provided to Parra and other similarly situated claimants "was constitutionally sufficient." The notice was sufficient, the court said, because it "was 'designed to inform as many future asbestos claimants as possible . . . [about the] proceedings,'" including national TV and radio ads and newspaper ads in the six leading U.S. and Canadian newspapers and the largest circulation daily newspaper in each state. (Ellipses and bracketed text by the Second Circuit.) The court was careful to state that it took "no position on what notice may be required under different circumstances, such as where a potential claimant does not receive the level of representation provided by the FCR."

***L.K. Comstock & Co. v. Reibie (In re RailWorks Corp.)*, No. 01-64463-MMH (Bankr. D. Md. March 2, 2020)**

Like *Marsh USA*, *RailWorks* involved a question about an asbestos claimant's ability to pursue claims many years after bankruptcy. Sixteen years after confirmation of the reorganized debtor's Chapter 11 plan, the claimants brought suit seeking to recover for injuries sustained from exposure to asbestos. The debtors in *RailWorks* were not asbestos defendants and did not obtain a § 524(g) channeling injunction during their bankruptcy case. Nevertheless, the bankruptcy court held that the claimants could not pursue their claims against the reorganized debtor because the debtor had "done all that it could reasonably do to identify and provide notice to potential creditors" such as the claimants. Accordingly, the ordinary discharge injunction available to all Chapter 11 debtors was sufficient to bar the claimants from proceeding with their claims.

The *RailWorks* debtors commenced their Chapter 11 proceedings in 2001. The claimants' claims were not listed on the Debtors' bankruptcy schedules (no claims had been asserted at that time), the claimants did not receive notice of the Chapter 11 cases, and they did not file proofs of claim or vote on the plan. The claimants filed their state court lawsuits against the reorganized debtor in 2018 and 2019. Applying the broad definition of "claim" in Section 101(5) of the Bankruptcy Code, the bankruptcy court held that the causes of action alleged by claimants in their state court actions were "claims" subject to treatment in the Chapter 11 cases.

The court held that the claims were discharged under § 1141(d) of the Bankruptcy Code, which implemented the reorganized debtor's "fresh start." The court noted that the effectiveness of a debtor's discharge depends on whether affected persons receive adequate notice and due process. Here, the court found that the claimants were "unknown creditors" and that the debtor's efforts to notify "unknown creditors" by publication complied with notice and due process requirements. For example, focusing on one of the claimants, the court held that he was an "unknown creditor" because the debtors had no knowledge at the time of the 2001 bankruptcy proceedings of the identity of the claimant (he was not an employee, but rather was employed by one of their predecessors), his potential claims, or any events giving rise to potential asbestos liabilities. In addition, the court found that the record contained no evidence of "red flags or factors that would have alerted the [debtors] of potential asbestos liabilities." Thus, the court concluded, publication notice was sufficient under the circumstances to discharge debtors' liabilities to the claimant.

***Maryland Cas. Co. v. The Asbestos Claims Court*, 2020 MT 70 (Mont. S. Ct. Mar. 25, 2020)**

This decision primarily addressed whether, under Montana state law, the claimants could hold Maryland Casualty Company liable for failure to warn them of the dangers of asbestos. Maryland Casualty had been the workers' compensation carrier for W.R. Grace, the claimants' employer. The court found that Maryland Casualty could be held liable for failure to warn, adopting the liability standards found in Restatement (Second) of Torts § 324A.

In addition, a concurring opinion by Montana's chief justice, joined by two other justices, stated that the § 524(g) channeling injunction issued in Grace's Chapter 11 case did not bar the claims against Maryland Casualty. The concurring justices found that the channeling injunction barred only claims that were "derivative" (*i.e.*, claims that sought recovery from the debtor's insurance policy based on the debtor's conduct, rather than the insurer's). The justices concluded, however, that the negligence and duty to warn claims asserted against Maryland Casualty were not "derivative" because the claims sought to impose liability on Maryland Casualty that was independent of the insurer's contractual indemnification obligations owed to Grace. The court concluded that "[t]he nature of the harm suffered by [the claimants] is predicated on [Maryland Casualty's] misconduct, not Grace's." "Accordingly," the justices stated, "any recovery will not affect Grace's res, but rather, will be satisfied directly through [Maryland Casualty's] assets." Grace's § 524(g) injunction therefore did not enjoin the claims.

Discussion

These decisions show that while channeling injunctions entered pursuant to confirmed Chapter 11 bankruptcy plans are broad, they are not without limits, and certain procedures must be followed to make such injunctions effective.

First, the injunctions will only bar claims against claimants whose due process rights have been honored. At a minimum, this means that claimants – including those unknown to the debtor during the bankruptcy – must be given adequate notice of the bankruptcy and the proposed injunction. In the case of unknown creditors, notice by publication is sufficient – and the more robust, the better. In addition, adequate representation of the claimants during the bankruptcy, perhaps by a future claimants representative, is also relevant. While asbestos channeling injunctions under § 524(g) of the Bankruptcy Code are expressly dependent on representation by an FCR appointed by the court during the Chapter 11 case, appointments of FCRs are also possible in non-asbestos cases, such as Chapter 11s involving sexual abuse by priests or injury from harmful substances other than asbestos.

Second, a channeling injunction will not protect a person or entity from their *own* wrongdoing; rather, it will only protect them for their derivative responsibility for the *debtor's* wrongdoing. Such derivative responsibility could be the result of having issued insurance to the debtor, or perhaps having agreed to indemnify the debtor against certain liabilities. But a defendant should not expect to evade responsibility for its own wrongdoing simply because it issued insurance to a reorganized debtor. (Application of the *Johns-Manville* injunction to independent claims is a special case, the U.S. Supreme Court held in 2009, because that injunction is entitled to *res judicata* effect against parties who participated in that bankruptcy and those in privity with them.)

Third, a special channeling injunction, issued pursuant to §§ 524(g) or 105 of the Bankruptcy Code, may not be necessary to protect a reorganized debtor against asbestos claims or other tort liability claims. So long as the debtor gave adequate notice of its bankruptcy case and its plan to unknown creditors, future claims by those unknown creditors may be barred by the ordinary Chapter 11 bankruptcy discharge, without the need for a special channeling injunction.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Mark D. Plevin
Partner – San Francisco, Washington, D.C.
Phone: +1 415.365.7446, +1 202.624.2801
Email: mplevin@crowell.com