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

By Mark D. Plevin[*]

Four recent court decisions address the scope and limits of bankruptcy injunctions barring future asbestos claims. The decisions underscore that channeling injunctions under § 524(g) of the Bankruptcy Code may not be the only effective way of enjoining asbestos claims against a reorganized debtor, and that broad notice of proposed injunctions is critical. The lessons of these cases should also apply to bankruptcy cases involving non-asbestos tort claims.

In re Energy Future Holdings Corp. (EFHC)

The EFHC debtors confirmed a plan of reorganization that did not invoke the special asbestos trust/channeling injunction provisions of § 524(g) of the Bankruptcy Code. The Third Circuit, affirming a ruling by Bankruptcy Judge Christopher S. Sontchi, held that the claims of future asbestos claimants nevertheless could be discharged "so long as the claimants receive an opportunity to reinstate their claims after the debtor's reorganization that comports with due process."[1]

Debtors' plan provided for payment of all asbestos claims that had been filed by the bar date, but did not provide for payment of future claims (or, as the court termed them, "latent claims").[2] The latent claimants—who knew they had been exposed to asbestos, but who had not yet manifested injuries—argued that a bar date violated their due process rights. The bankruptcy court disagreed, finding that such persons could still file claims after the bar date and obtain payment if they could show that debtors' notice program (which cost over $2 million, and "led nearly 10,000 latent claimants to file proofs of claim before" the bar date) was unconstitutional, as applied to them.[3]

The Third Circuit held that debtors' pre-confirmation notice program—which included publication in "seven consumer magazines, 226 local newspapers, three national newspapers, forty-three Spanish-language newspapers, eleven union publications, and five Internet outlets"—"was sufficient" to provide notice of the bar date.[4] This was particularly so given that the bankruptcy court retained jurisdiction under the plan "to consider whether it unconstitutionally discharged individual [latent] claims" and was

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required to "accept late-filed proofs of claim under" Bankruptcy Rule 3003(c)(3) for "cause shown."[5] The Third Circuit was persuaded "that deserving latent claimants will have adequate opportunity to obtain reinstatement through Rule 3003(c)(3) motions and that this path to relief is not, as Appellants assert, categorically incapable of affording due process to latent claimants."[6]

The court noted that it was not foreclosing an "as-applied challenge by any latent claimant who contends that" the Rule 3003(c)(3) process did not provide due process. In fact, the court essentially outlined the arguments that latent claimants could make to establish that the debtors' plan could not constitutionally discharge their claims.[7] Although the court acknowledged that latent claimants would carry the burden of proof under Rule 3003(c)(3), the court said that burden "is a light one," requiring them to "only file a basic motion reciting the fact that reinstatement of their claim will neither prejudice [debtor] nor impact its bankruptcy proceedings and attach a sworn affidavit explaining why they were deprived of due process."[8]

Marsh USA v. The Bogdan Law Firm (In re Johns-Manville Corp.)

In this case, the Second Circuit held that tort claims against Marsh USA were barred by asbestos channeling injunction orders entered in 1986 in the *Johns-Manville* bankruptcy. The court of appeals held that the 1986 orders channeled into the Manville Trust "all Johns-Manville related claims against settling insurers and insurance brokers (including Marsh)."[9]

One claimant, Salvador Parra Jr., argued that the 1986 orders—precursors to the channeling injunctions now common in asbestos bankruptcies under § 524(g) of the Bankruptcy Code—should not enjoin his claims against Marsh because he had not received sufficient due process during the Manville bankruptcy proceeding to be bound by the 1986 orders. Bankruptcy Court Chief Judge Cecilia G. Morris rejected Parra's argument, finding that the injunction was enforceable because Parra's interests were "represented *in absentia*" by the future claims representative (FCR) appointed during the Manville bankruptcy "to advocate for parties like Parra who may have been harmed by Johns-Manville's asbestos products, but who had not yet manifested symptoms of asbestos-related disease."[10] The district court reversed,[11] but the Second Circuit reversed the district court, 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 *res* of the bankruptcy estate) could not properly be channeled, although the injunction purported to do so.[12] The Second Circuit noted that in 1985, the FCR had argued that the injunction should be limited to claims arising from the contractual obligation of settling insurers to cover Manville's liability (which the court described as "*in rem*" claims).[13] However, the bankruptcy court in 1986 rejected the FCR's argument and instead enjoined both *in personam* and *in rem* claims. In this appeal, the Second Circuit concluded that the FCR's advocacy 34 years earlier had

provided Parra with adequate representation, even though the bankruptcy court in 1986 had rejected the FCR's arguments. The Second Circuit noted that this was "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*."[14] Because the record showed that the FCR advocated to exclude *in personam* claims from the injunction 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."[15]

The Second Circuit then ruled that the notice provided during the original bankruptcy proceedings "was constitutionally sufficient" for Parra "to be bound by the 1986 Orders."[16] The notice "was 'designed to inform as many future asbestos claimants as possible . . . [about the] proceedings,' " including by running 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.[17] 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" to Parra.[18]

L.K. Comstock & Co. v. Reibie (In re RailWorks Corp.)[19]

The bankruptcy court in *RailWorks* also recently considered whether asbestos claimants could pursue claims against a reorganized debtor many years after bankruptcy. The debtors in *RailWorks* had not been sued for asbestos claims before or during their bankruptcy and they did not seek or obtain a § 524(g) channeling injunction during their bankruptcy case. Nevertheless, Bankruptcy Judge Michelle M. Harner 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.[20] Accordingly, the court held, the ordinary discharge injunction available to all chapter 11 debtors was sufficient to bar the claimants from proceeding with their claims.

The *RailWorks* debtors' plan became effective in 2002. It "release[d] and enjoin[ed] all claims that were or could have been filed against the Debtors and resolved in the context of the claims administration process."[21]

The claimants filed their state court lawsuits against the reorganized debtors in 2018 and 2019, based on asbestos exposure allegedly suffered through the 1990s. Their claims were not listed on the debtors' bankruptcy schedules (no asbestos claims had been asserted against the debtors at that time), they did not receive direct notice of the chapter 11 cases, and they did not file proofs of claim or vote on the plan.

As a threshold matter, the bankruptcy court applied the broad definition of "claim" in § 101(5) of the Bankruptcy Code and held that the causes of action alleged in the claimants' state court actions were "claims" subject to treatment in the chapter 11 cases. For example, the court observed that claimant Ronald Reibie's "interaction with the [reorganized debtor], through its predecessor, certainly predated the bankruptcy and was prepetition in

nature."[22] Because, in the Fourth Circuit, a claim "arises upon exposure, not manifestation," Reibie's claims "arose prepetition, at the time of [his] alleged asbestos exposure."[23]

The court said that whether a claimant's claims are discharged depends on whether he received adequate notice and due process, and that publication can satisfy notice and due process requirements as to unknown claimants. The court held that Reibie was an "unknown creditor" because the debtors had no knowledge of him (he was not their employee, but rather had been employed by one of their predecessors), his potential claims, or any events giving rise to potential asbestos liabilities.[24] Thus, the court concluded, publication notice (here, just in the national edition of the *Wall Street Journal*)[25] was "adequate notice under the circumstances" to "satisfy the Reibie Defendants' due process rights and subject [their] claims to discharge in the Debtors' chapter 11 cases."[26]

Maryland Cas. Co. v. Asbestos Claims Court

This decision primarily addressed whether, under Montana 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.[27]

A concurring opinion stated that the § 524(g) channeling injunction issued in Grace's chapter 11 case did not bar the claims against Maryland Casualty.[28] The concurring opinion 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 own conduct). The opinion concluded that the negligence and duty to warn claims asserted against Maryland Casualty were not "derivative," however, because they sought to impose liability on Maryland Casualty that was independent of its contractual indemnification obligations owed to Grace. "The nature of the harm suffered by [the claimants] is predicated on [Maryland Casualty's] misconduct, not Grace's."[29] "Accordingly," the opinion stated, "any recovery will not affect Grace's res, but rather, will be satisfied directly through [Maryland Casualty's] assets."[30] 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, an injunction—whether under § 524(g) or § 524(a)—will only bar claims where claimants' 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 sufficiene—and the more robust, the better. In addition, adequate representation of the claimants during the bankruptcy, perhaps by an FCR, is also relevant. While asbestos channeling injunctions under § 524(g) require 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 cases involving sexual abuse by priests or injury from harmful substances other than asbestos.

Second, § 524(g) may not be the only effective way to address future asbestos claims. *RailWorks* applied the discharge injunction to bar asbestos claims. Likewise, asbestos claims will be barred by the discharge injunction in *EFHC*, subject to the possibility of a claimant's being allowed to file a late proof of claim. While not seeking § 524(g) relief provides asbestos debtors with flexibility, it is not without risk that future claimants will be able to prove that the discharge injunction should not be applied to them.

Last, as shown by the *Maryland Casualty Company* decision in the *Grace* case, a § 524(g) channeling injunction will not protect an entity from its own wrongdoing—only for its derivative responsibility for the debtor's wrongdoing, through having issued insurance to the debtor or perhaps having agreed to indemnify the debtor against certain liabilities. But a defendant cannot expect to evade responsibility for its own wrongdoing simply because it issued insurance to the debtor.[31]

NOTES:

[1]In re Energy Future Holdings Corp, 949 F.3d 806, 811, 68 Bankr. Ct. Dec. (CRR) 89, Bankr. L. Rep. (CCH) P 83493 (3d Cir. 2020).

[2]949 F.3d at 814.

[3]949 F.3d at 814.

[4]949 F.3d at 823.

[5]949 F.3d at 823.

[6]949 F.3d at 823.

[7]949 F.3d at 823-24, citing In re Grossman's Inc., 607 F.3d 114, 53 Bankr. Ct. Dec. (CRR) 56, Bankr. L. Rep. (CCH) P 81777 (3d Cir. 2010) (en banc).

[8]949 F.3d at 824.

[9]In re Johns-Manville Corporation, 802 Fed. Appx. 20, 23, 68 Bankr. Ct. Dec. (CRR) 99 (2d Cir. 2020).

[10]802 Fed. Appx. at 23. Judge Morris' decision is reported at In re Johns-Manville Corporation, 581 B.R. 38 (Bankr. S.D. N.Y. 2018).

[11]In re Johns-Manville Corporation, 319 F. Supp. 3d 633, 66 Bankr. Ct. Dec. (CRR) 7 (S.D. N.Y. 2018).

[12]See Marsh USA, Inc., 802 Fed. Appx. at 23 ("The 1986 Orders channel all Johns-Manville-related claims against settling insurers and insurance brokers (including Marsh)

. . . into the Manville Trust—whether those claims arise from the Settling Insurers' contractual obligation to cover Johns-Manville's liability (in rem claims) or from their own conduct 'based upon, arising out of or relating to' that coverage (in personam claims)"), quoting Travelers Indem. Co. v. Bailey, 557 U.S. 137, 148–51, 129 S. Ct. 2195, 174 L. Ed. 2d 99, 51 Bankr. Ct. Dec. (CRR) 210, 61 Collier Bankr. Cas. 2d (MB) 1441, Bankr. L. Rep. (CCH) P 81505 (2009).

[13]802 Fed. Appx. at 23–24.

[14]802 Fed. Appx. at 24.

[15]802 Fed. Appx. at 24.

[16]802 Fed. Appx. at 24.

[17]802 Fed. Appx. at 24, quoting Matter of Johns-Manville Corp., 68 B.R. at 626 (ellipses and bracketed text by the Second Circuit).

[18]802 Fed. Appx. at 25.

[19]In re RailWorks Corporation, 613 B.R. 853, 68 Bankr. Ct. Dec. (CRR) 122 (Bankr. D. Md. 2020).

[20]613 B.R. at 857.

[21]613 B.R. at 857.

[22]613 B.R. at 862.

[23]613 B.R. at 864, quoting In re Lloyd E. Mitchell, Inc., 373 B.R. 416, 424, 48 Bankr. Ct. Dec. (CRR) 227 (Bankr. D. Md. 2007).

[24]613 B.R. at 870–71.

[25]613 B.R. at 871 n.22

[26]613 B.R. at 872. The court noted, however, that "additional or more local publication may have been preferable." 613 B.R. at 871 n.22.

[27]Maryland Casualty Company v. Asbestos Claims Court, 2020 MT 70, 399 Mont. 279, 320, 460 P.3d 882, 907 (2020).

[28]The concurring opinion addressed whether the claims against Maryland Casualty were enjoined because the issue had not been definitively decided in connection with Grace's bankruptcy. After the bankruptcy court had held the claims against both Maryland Casualty and another insurer, CNA, were "derivative" and thus enjoined, the Third Circuit vacated the bankruptcy court's ruling and remanded with instructions. 399 Mont. 331 n.3, 460 P.3d at 914 (McGrath, C.J., concurring), citing In re W.R. Grace & Co., 900 F.3d 126, 130, 66 Bankr. Ct. Dec. (CRR) 23 (3d Cir. 2018). On remand, the bankruptcy court held that the claims against CNA were not enjoined, but did not address the claims against Maryland Casualty. See 399 Mont. 331 n.3., citing In re W.R. Grace & Co., 607 B.R. 419, 423 (Bankr. D. Del. 2019).

[29]399 Mont. at 332, 460 P.3d at 915.

[30]399 Mont. at 332.

[31]*Marsh USA* shows that application of the *Johns-Manville* injunction to independent claims is a special case. The Supreme Court has held that that injunction is entitled to res judicata effect against parties who participated in that bankruptcy and those in privity with them. Travelers Indem. Co. v. Bailey, 557 U.S. at 152.