Bloomberg BNA

BNA's
Bankruptcy Law Reporter™

A Tale of Two Circuits: The Third and Fifth Circuits Diverge in Balancing the Debtor's Interest in a Fresh Start with the Due Process Rights of Future Asbestos Claimants



By Paul M. Singer, Edwin J. Harron and Sara Beth A.R. Kohut

Federal courts have struggled with the tension between the ''fresh start'' many companies hope to achieve in bankruptcy and the due process issues implicated by discharging latent claims (22 BBLR 820, 6/17/10).[1] Inadequate protection of future claimants' rights to notice and the absence of a meaningful opportunity for future claimants to object to the reorganization proceedings threatens the finality of the debtor's ''fresh start.''[2] In 1994, Congress amended the Bank-

Paul M. Singer is a partner at Reed Smith LLP in Pittsburgh, Pennsylvania, where his practice includes representing debtors in cases under 11 U.S.C. Section 524(g). Edwin J. Harron is a partner and Sara Beth A.R. Kohut is an associate at Young Conaway Stargatt & Taylor, LLP in Wilmington, Delaware, where their practice focuses on representing future claimants' representatives in cases under 11 U.S.C. Section 524(g) and in connection with asbestos settlement trusts established pursuant to that statute.

Christopher Fry, a second year law student at the University of Virginia School of Law and a 2014 summer associate at Young Conaway, also contributed to this article.

[1] *See, e.g., JELD-WEN, Inc. v. Van Brunt (In re Grossman's Inc.)*, 2010 BL 122454, at **6, 607 F.3d 114, 122 (3d Cir. 2010) (''. . . Congress' intent to provide debtors with a fresh start [is] an objective . . . 'made more feasible by maximizing the scope of a discharge.' On the other hand, a broad discharge may disadvantage potential claimants, such as tort claimants, whose injuries were allegedly caused by the debtor but which have not yet manifested and who therefore had no reason to file claims in the bankruptcy. These competing considerations have not been resolved consistently by the cases decided to date.'' (internal citation omitted)).

[2] *See Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (''An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.''); *Grossman's*, 607 F.3d at 122 (''If potential future tort claimants have not filed claims because they are unaware of their injuries, they might challenge the effectiveness of any purported notice of the claims bar date. Discharge of such claims without providing adequate notice raises questions under the Fourteenth Amendment.'' (citing *Mullane*, 339 U.S. at 314)); *Jones v. Chemetron Corp.*, 212 F.3d 199, 209-10 (3d Cir. 2000) (''Under fundamental notions of procedural due process, a claimant who has no appropriate notice of a bankruptcy reorganization cannot have his claim extinguished in a settlement pursuant thereto.''); *White v. Jacobs (In re New Century TRS Holdings, Inc.)*, No. 13-1719-SLR, 2014 BL 230334, at *5 (D. Del. Aug. 20, 2014) (''Notice is '[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality[.]' . . . Inadequate notice accordingly 'precludes discharge of a claim in bankruptcy.' '' (quoting *Mullane*, 339 U.S. at 314, and *Chemetron Corp. v. Jones*, 72 F.3d 341, 346 (3d Cir. 1995))); *In re Johns-Manville Corp.*, 36 B.R. 743, 746 (Bankr. S.D.N.Y. 1984) (''Any plan emerging from

 ISSN 1044-7474

ruptcy Code to address that tension in the context of asbestos claims by adding Section 524(g). Under that section, a company plagued by asbestos claims can receive a discharge of its asbestos liabilities by establishing a trust to which those liabilities are channeled for resolution.[3] Protection under Section 524(g) is subject to satisfaction of numerous criteria intended to protect the due process rights of claimants—particularly future claimants, i.e., persons who have been exposed to asbestos but have yet to manifest an injury.[4]

The U.S. Courts of Appeals for the Third and Fifth Circuits have reached divergent results in factually similar cases that involved challenges to the discharge of latent asbestos claims, more than a decade after the debtors obtained confirmation of plans that did not utilize Section 524(g). In *JELD-WEN, Inc. v. Van Brunt (In re Grossman's Inc.)*,[5] the Third Circuit Court of Appeals held that remand was necessary for a factual inquiry to determine whether discharge comported with due process. In contrast, the Fifth Circuit Court of Appeals recently held, in *Williams v. Placid Oil Co. (In re Placid Oil Co.)*,[6] that discharge had been properly effected through constructive notice (26 BBLR 761, 6/5/14).

Grossman's and Placid Oil Had Similar Factual Backgrounds.

Both *Grossman's* and *Placid Oil* involved claims based upon a woman's death from mesothelioma allegedly caused by exposure to asbestos decades before the respective debtor filed for bankruptcy protection. Mary Van Brunt allegedly was exposed to asbestos-containing products purchased in 1977 from home improvement retailer Grossman's, which filed for bankruptcy protection in 1997 and obtained confirmation of a plan that same year.[7] Van Brunt was diagnosed with mesothelioma in 2007 and died the next year.[8] She and her husband filed suit against the successor-in-interest to Grossman's, JELD-WEN, in 2007.[9]

Myra Williams allegedly was exposed to asbestos secondarily by washing the work clothes of her husband, who had been employed by Placid Oil for more than 20 years when it filed for bankruptcy protection in 1986.[10] Williams was diagnosed with mesothelioma in 2003 and died the same year.[11] In 2004, her husband, Jimmy Williams, sued Placid Oil.[12] Both JELD-WEN and Placid Oil sought to reopen their respective bankruptcy cases, asserting that the plaintiffs held pre-petition claims that had been discharged through the plans confirmed in those cases.[13]

Although Grossman's filed its chapter 11 case after Congress had enacted Section 524(g), Grossman's did not qualify for Section 524(g) protection because it had yet to be named in any asbestos-related lawsuits.[14] Placid Oil filed its chapter 11 case before Congress enacted Section 524(g). Like Grossman's, Placid Oil had yet to be named a defendant in any asbestos litigation by the time of its petition.[15] Both companies knew, at the time of their filings, about the dangers posed by asbestos exposure, and that their operations had caused some individuals to be exposed to asbestos.[16]

In *Grossman's*, the Third Circuit delineated a multifactor test for the lower courts to apply in determining whether discharge of the Van Brunt claim comported with due process.[17] The court noted that the inquiry may entail analysis of the adequacy of notice of the claims bar date.[18] In *Placid Oil*, however, the Fifth Circuit concluded (in the majority's opinion) that the Williamses were unknown creditors whose pre-petition claim was discharged by constructive notice.[19] The court further held that the notice was not substantively deficient even though it made no reference to potential asbestos liability.[20] In his dissenting opinion in *Placid Oil*, Judge Dennis vociferously rejected the majority's approach, arguing that the result violated due process and overlooked the latency problems inherent in asbestos claims.[21]

Although the Courts Began With Similar Analyses, They Reached Different Outcomes.

Both Courts of Appeals employed a two-step analysis that considered whether the respective plaintiffs held pre-petition claims and, if so, whether the defendants satisfied procedural due process by providing adequate notice of the claims bar date. In the first step, the Third Circuit brought its jurisprudence in line with that of other jurisdictions by discarding the accrual test[22] in favor of the pre-petition relationship test, pursuant to which ''a 'claim' arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a 'right to payment' under the Bankruptcy Code.''[23] The lower courts in *Placid Oil* also applied the pre-petition relationship test in the first step of the analysis.[24]

The Third Circuit concluded that the *Grossman's* plaintiffs held pre-petition claims.[25] The Fifth Circuit

this case which ignores [future] claimants would serve the interests of neither the debtor nor any of its other creditor constituencies in that the central short and long-term economic drain on the debtor would not have been eliminated. Manville might indeed be forced to file again and again if this eventuated.'').

[3] 11 U.S.C. § 524(g).

[4] *See id*., *Grossman's*, 607 F.3d at 126 & n.12 (citing, inter alia, *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 234 n.45 (3d Cir. 2005)).

[5] 607 F.3d 114 (3d Cir. 2010).

[6] 2014 BL 146451, 753 F.3d 151 (5th Cir. 2014).

[7] 607 F.3d at 117.

[8] *Id*.

[9] *Id*.

[10] 753 F.3d at 153.

[11] *Id*.

[12] *Id*.

[13] 607 F.3d at 118; 753 F.3d at 153.

[14] *Grossman's*, 607 F.3d at 127 n.13.

[15] *See Placid Oil*, 753 F.3d at 153.

[16] *Id.* at 153; *Grossman's*, 607 F.3d at 117.

[17] *Grossman's*, 607 F.3d at 127-28. Because the parties in *Grossman's* ultimately settled their dispute, the bankruptcy court did not have an opportunity to apply the due process standard articulated by the Court of Appeals.

[18] *Id.* at 127.

[19] *Placid Oil*, 753 F.3d at 157-58.

[20] *Id.* at 158.

[21] *Id.* at 159-64.

[22] Under the accrual test, a claim arose for bankruptcy-law purposes at the time when the claim accrued under applicable state law. *Grossman's*, 607 F.3d at 119.

[23] *Id.* at 125.

[24] *See Placid Oil*, 753 F.3d at 154 n.1.

[25] *Grossman's*, 607 F.3d at 125.

  BBLR ISSN 1044-7474

was not obligated to, and did not, decide the issue, since the *Placid Oil* plaintiffs did not appeal the finding of the bankruptcy court that their claims were pre-petition.[26] The Fifth Circuit confined itself to observing that *Wright v. Owens Corning*,[27] decided after *Grossman's*, ''raise[d] doubts as to whether the Williamses actually had dischargeable claims[,]'' and that the district court might have misread Fifth Circuit precedent when determining that the Williamses' claims were subject to discharge.[28] The *Placid Oil* dissent, by contrast, argued the court had a ''duty to future victims of mesothelioma and other latent diseases, to acknowledge and correct, rather than to paper over, the errors plainly evident in the bankruptcy court's decision below.''[29]

Where the Courts of Appeals diverged was in the second step of the analysis—determining whether the plaintiffs' claims were discharged in the Chapter 11 process in light of the procedural due process implications specific to asbestos exposure, especially the requirement of notice. The Third Circuit focused on the principles of due process as providing the criteria by which an asbestos claim that arose pre-petition might be discharged absent strict compliance with the protective measures embodied in Section 524(g):

> In determining whether an asbestos claim has been discharged, the court may wish to consider, inter alia, the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties, including whether it was reasonable or possible for the debtor to establish a trust for future claimants as provided by § 524(g).[30]

In contrast, the Fifth Circuit reasoned, first, that the Williamses were ''unknown creditors'' when notice of the bar date was issued, because, while asbestos claims may have been ''foreseeable'' to Placid Oil at that time, it ''had no specific knowledge of any actual injury to the Williamses[.]''[31] The court then concluded that due process had been satisfied through publication notice.[32] The court's analysis relied substantially on *Mullane v. Central Hanover Bank & Trust Co*.,[33] a case that did not involve latent personal injury claims and was decided in 1950, well before asbestos litigation came to the fore.

The Decisions Should Be Considered in the Context of Asbestos Litigation.

Grossman's and *Placid Oil* must be assessed in the context of the history of asbestos litigation and the policies that led to the creation of Section 524(g). It was a Fifth Circuit decision, *Borel v. Fibreboard Paper Products Corp*., that opened the floodgates for asbestos litigation by holding that asbestos manufacturers were strictly liable to workers who were injured by exposure to the manufacturers' asbestos products.[34] Nearly a decade after *Borel*, UNR and Johns-Manville, two prominent asbestos-product suppliers faced with overwhelming asbestos liability, filed for bankruptcy protection.[35] The challenges of discharging asbestos claims—particularly latent future claims—were central to those bankruptcy proceedings. The *UNR* court recognized the tension between the due process concerns of individuals with latent injuries and the debtors' interest in a ''fresh start'' as contemplated by the Bankruptcy Code:

> The debtors . . . . argue, in effect, that the Congressional intention to provide the possibility of a ''fresh start'' to entities suffering under grave financial disabilities includes the intention to subordinate to the ''fresh start'' concern the statutory and constitutional rights of those who do not yet know that they will in the future suffer from a dread disease. A ''fresh start'' for these debtors is not as important as this.[36]

Likewise, the *Johns-Manville* court noted that due process served ''to preserve the rights and remedies of those parties, who by an accident of their disease cannot even speak in their own interest.''[37] The court authorized ''an extensive campaign designed to provide the maximum amount of publicity . . . that was reasonable to expect of man and media[,]'' and explained that ''[t]his publicity campaign was designed to inform as many future asbestos claimants as possible of the impact of the Manville reorganization upon whatever rights they might have against the Debtor and give them a voice in these proceedings.''[38] In addition, key to the ability to bind unknown parties in interest in *Johns-Manville* was the appointment of the Legal Representative for Future Claimants.[39]

---

[26] *Placid Oil*, 753 F.3d at 154 n.1.

[27] 679 F.3d 101 (3d Cir. 2012), *cited in id.*

[28] *Placid Oil*, 753 F.3d at 154 n.1.

[29] *Id.* at 160.

[30] *Grossman's*, 607 F.3d at 127-28; *see also White*, 2014 BL 230334, at *7 (''While the Third Circuit generally deems notice by publication in national newspapers sufficient to satisfy the requirements of due process for unknown claimants, whether adequate notice has been provided depends on the circumstances of a particular case. . . . Due process requires notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.'' (internal quotation marks omitted)).

[31] *Placid Oil*, 753 F.3d at 156-57.

[32] *Id.* at 158.

[33] 339 U.S. 306 (1950).

[34] 493 F.2d 1076 (5th Cir. 1973).

[35] *Common Law Settlement Counsel v. Travelers Indem. Co. (In re Johns-Manville Corp.)*, 2014 BL 201796, at **1-2, 759 F.3d 206, 209 (2d Cir. 2014) (Johns-Manville Corporation was ''once the largest supplier of asbestos and asbestos-containing products. In 1982, after asbestos-related health problems triggered litigation, Manville, faced with the prospect of tremendous liability, filed a Chapter 11 petition for bankruptcy protection and reorganization.'' (internal citations omitted)); *In re UNR Indus., Inc.*, 29 B.R. 741, 743 (N.D. Ill. 1983) (''On July 29, 1982, UNR Industries, Inc., and ten of its subsidiaries and affiliates . . . filed voluntary petitions for reorganizations under Chapter 11 of the Bankruptcy Code . . . . The principal reason stated by the debtors for their filing the bankruptcy petitions is their involvement as defendants in some 17,000 asbestos-related personal injury lawsuits pending in various state and federal courts, exposing them to potential liabilities, high damages, and substantial costs of legal services.'').

[36] *UNR*, 29 B.R. at 748.

[37] *In re Johns-Manville Corp.*, 68 B.R. 618, 627 (Bankr. S.D.N.Y. 1986).

[38] *Id.* at 626.

[39] *Id.* at 626-27.

From the UNR and Johns-Manville cases emerged a paradigm for effectively resolving future claims: appoint a representative to act as guardian for the interests of future asbestos claims, create a trust to pay asbestos claims over time, and channel existing and future claims to that trust.[40] Congress codified that structure in Section 524(g) to definitively provide debtors a fresh start and future claimants a fair opportunity for recovery:

> It is the uncertainty of the number and amount of these future [asbestos] claims, and the need to implement a procedure that recognizes these future claimants as creditors under the U.S. Bankruptcy Code, that necessitates this amendment, as well as the need to provide some assurance that funds will be available to pay future claims. To those companies willing to submit to the stringent requirements in this section designed to ensure that the interests of asbestos claimants are protected, the bankruptcy courts' injunctive power will protect those debtors and certain third parties, such as their insurers, from future asbestos product litigation of the type which forced them into bankruptcy in the first place.[41]

The bankruptcy solution gained favor because, not long after the enactment of Section 524(g), asbestos class-action litigation hit a wall in the form of *Georgine v. Amchem Products Inc.*[42] As the Third Circuit stated in *Georgine*, ''we do not see how an action of this magnitude and complexity could practically be tried as a litigation class. This problem, when combined with the serious fairness concerns caused by the inclusion of futures claims, make[s] it impossible to conclude that this class action is superior to alternative means of adjudication.''[43] The Supreme Court affirmed, noting that Congress had not adopted a (non-bankruptcy) solution, such as ''a nationwide administrative claims processing regime[.]''[44] Section 524(g) thus became the means by which a debtor could obtain a discharge of latent future claims while accounting for the due process implications of such claims.

Placid Oil Ignored the Due Process Problems Addressed by Section 524(g).

The *Placid Oil* ruling disregards the policies and precedent addressed by Section 524(g). The Fifth Circuit relied on *Mullane* to find that notice by publication (via three advertisements in the *Wall Street Journal* that did not even mention the possibility of asbestos exposure) was adequate to satisfy due process, notwithstanding the plight of future claimants who did not know they were sick at the time the notice was provided.[45] That result is a far cry from the *Johns-Manville* court's efforts to satisfy due process, requiring both the ''maximum amount of publicity . . . that was reasonable to expect of man and media'' and the appointment of a representative to protect the interests of claimants with as-yet-unknown injuries.[46]

The dissent in *Placid Oil* argued that liabilities to future latent-disease claimants should not be dischargeable absent the appointment of a representative to protect their due process interests.[47] Constructive notice cannot be effective for ''claimants who are not only unknown but unselfconscious and amorphous, as are future claimants in bankruptcy, such as Myra Williams with her unknown, latent asbestos claim.''[48] The dissent pointed out that, in *Amchem*, the Supreme Court recognized this very problem, in that the Court refused to find class-action certification proper because of the obstacles to providing notice to ignorant claimants, especially those (like Myra Williams) who are family members of persons directly exposed to asbestos:

> ''Family members of asbestos-exposed individuals may themselves fall prey to disease or may ultimately have ripe claims for loss of consortium. Yet large numbers of people in this category—future spouses and children of asbestos victims—could not be alerted to their class membership. And current spouses and children of the occupationally exposed may know nothing of that exposure.
>
> ''. . . [W]e recognize the gravity of the question whether class action notice sufficient under the Constitution and Rule 23 could ever be given to legions so unselfconscious and amorphous.
>
> . . . .
>
> . . . ''Even if they fully appreciate the significance of [the] notice, those without current afflictions may not have the information or foresight needed to decide, intelligently, whether'' to participate in the bankruptcy.[49]

The Fifth Circuit also failed to fully account for the fact that Placid Oil knew the extent and scope of its employees' exposure to asbestos, whereas Myra Williams had limited understanding (if any) of her vulnerability to secondary asbestos exposure.[50] Placid Oil sought reorganization in 1986, at a time when asbestos litigation

[40] 140 Cong. Rec. S4521-01 (daily ed. April 20, 1994) (statement of Sen. Graham); 140 Cong. Rec. H10,752 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks, inserting section-by-section analysis of Bankruptcy Reform Act of 1994).

[41] 140 Cong. Rec. S4521-01 (daily ed. April 20, 1994) (statement of Sen. Graham).

[42] 83 F.3d 610 (3d Cir. 1996), *aff'd sub nom. Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997).

[43] *Id.* at 618.

[44] *Amchem*, 521 U.S. at 628-29.

[45] *Placid Oil*, 753 F.3d at 156-58.

[46] *Johns-Manville*, 68 B.R. at 626 (internal quotation marks omitted).

[47] *Placid Oil*, 753 F.3d at 162 (Dennis, J., dissenting).

[48] *Id.* at 160 (internal quotation marks omitted).

[49] *Id.* at 161 (quoting *Amchem*, 521 U.S. at 628).

[50] The Fifth Circuit seemed to accord greater significance to the knowledge purportedly possessed by the latent future claimants than that of the debtor seeking discharge. In doing so, the court appears to have silently equated Mr. Williams's knowledge of his own risk of disease from direct exposure, to knowledge on the part of his wife regarding her individual risk from secondary exposure. Thus, the court noted, ''By the early 1980s, Placid was aware, generally, of the hazards of asbestos exposure and, specifically, of Mr. Williams's exposure in the course of his employment[,]'' and ''Mr. Williams was aware of his vulnerability: He knew that he was exposed to asbestos in his work, and the dangers of asbestos were widely known at the time . . . .'' *Id.* at 153, 155 n.2. Yet, as the dissent pointed out, there was no evidence that ''Myra Williams was aware of either her exposure to asbestos dust and fibers or that she might someday grow ill and die as a consequence of that exposure.'' *Id.* at 164.

  BBLR ISSN 1044-7474

had already forced Johns-Manville and UNR into bankruptcy, in cases that highlighted the due process implications of discharging future asbestos claims. Myra Williams, on the other hand, simply had nothing to put her on notice of any injury for which she had a colorable claim at the time of the bar date. Even if her husband had understood the extent of his vulnerability and had filed a proof of claim before the bar date, it is unreasonable to expect that Myra Williams would have understood her own risk of compensable injury as a consequence of laundering her husband's clothes. As the dissent noted, even if future claimants receive notice, they are ''often unable to recognize that their rights will be affected by the bankruptcy . . . because they have yet to manifest any injuries by the time the debtor files for bankruptcy.''[51] Accordingly, constructive notice is insufficient: when ''an individual cannot recognize that he or she has a claim in a bankruptcy case . . . that person is functionally or constructively incompetent . . . . These claimants . . . have no ability to represent their own interests in the bankruptcy case because they cannot be given the information necessary to enable them to make decisions about those interests.''[52]

Enforcing the bar date against claimants who had only latent injuries before that date is unfair for an additional reason: injured parties who comply with such a rule could later find their claims time-barred as a result. A claim filed by an individual with no current diagnosis of disease could be deemed to trigger the limitations period under applicable state law, risking a premature cut-off of any possible recovery by the claimant.[53]

Placid Oil should have favored due process interests over the debtor's ''fresh start.''

The Fifth Circuit's decision gave Placid a huge victory in holding that publication notice was sufficient to discharge the claim of an asbestos creditor who, at the time of the bar-date notice, had no reason to be aware of either her exposure or (future) disease. That said, the Court noted, however, that Mrs. Williams had waived the right to argue that she was not the holder of a prepetition claim subject to discharge, and that a future panel ''[a]ssisted by proper briefing'' might interpret the applicable law differently.[54] Nevertheless, while stating that it was ''not unsympathetic to fairness concerns,''[55] the majority missed the opportunity to add to the jurisprudence on the fundamental due process issue that arises when the bankruptcy principle of a fresh start intersects with a tort system that has come to recognize that the statute of limitations for asbestos and other long tail claims begins to run when the plaintiff first becomes aware of her injury. It would have been a far, far better thing for the Court to have done so.

---

[51] *Id.* at 161.

[52] *Id.* at 162 (internal quotation marks omitted).

[53] *See In re UNR Indus., Inc.*, 71 B.R. 467, 474 n.17 (Bankr. N.D. Ill. 1987) (explaining the dangers of filing a claim before the claimant ''actually gets an asbestos disease'').

[54] *Placid Oil*, 753 F.3d at 154 n.1.

[55] *Id.* at 157.