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QUARTERLY BANKRUPTCY UPDATE

In this update, we've summarized several notable bankruptcy-related decisions that were issued during the second quarter of this year that you may find of interest, including the Supreme Court addressing the Circuit split on U.S. Trustee fees, the Third Circuit clarifying the interaction of the Rules of Professional Conduct and section 327 of the Bankruptcy Code, and the Delaware Bankruptcy Court confirming a plan that provides for full payment of a debtor's asbestos liabilities. This update also includes an interesting decision from earlier this year out of the District Court for the Western District of North Carolina, which considered a bankruptcy court's authority to issue injunctive relief in favor of non-debtors. Each of these decisions, as well as several other recent rulings that we believe are worthy of review, is summarized below. Feel free to contact any member of our team for further information about these cases.

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Neither a Straitjacket Nor Toothless: The Supreme Court Strikes Down the 2017 U.S. Trustee Fee Rate Increase for Chapter 11 Debtors As Violative of the Bankruptcy Clause's Uniformity Requirement

Siegel v. Fitzgerald, 596 U.S. ___ 2022, No. 21-441, slip op. at 13 (June 6, 2022)

On June 6, 2022, in *Siegel v. Fitzgerald*, the United States Supreme Court struck down the 2017 U.S. Trustee fee rate increase for Trustee Program districts, holding that the Bankruptcy Clause's uniformity requirement prohibits Congress from treating identical debtors differently based on an artificial funding distinction.

The dispute at issue in *Siegel* arose from the bankruptcy proceedings of Circuit City Stores, Inc. filed in 2008 in the United States Bankruptcy Court for the Eastern District of Virginia. Circuit City's liquidation plan was still pending in 2017 when Congress enacted a "temporary, but significant increase in the [U.S. Trustee] fee rates applicable to large Chapter 11 Cases" in Trustee Program Districts (the "**2017 Act**"). Significantly, every federal judicial district, except the six judicial districts in North Carolina and Alabama is a "Trustee Program District" and was subject to the fee rate increase. Under the 2017 Act, Circuit City paid a total of $632,542 during the first three quarters of 2018; $500,000 more than an identical debtor would have paid in an Administrator Program district.

Thereafter, Circuit City commenced litigation in the Bankruptcy Court, arguing that the fee increase under the 2017 Act violated the Bankruptcy Clause of the United States Constitution due to its non-uniform application across Trustee Program and Administrator Program districts. The Bankruptcy Court agreed, but a divided panel of the United States Court of Appeals for the Fourth Circuit reversed finding that the Bankruptcy Clause's uniformity requirement "forb[ade] 'only "arbitrary" geographic differences.'" The Fourth Circuit reasoned that the geographic component of the 2017 Act was non-arbitrary because it applied only to Trustee Program Districts, which were the only districts affected by the U.S. Trustee's fund's budgetary shortfall. The Supreme Court granted certiorari to resolve two questions related to the constitutionality of the 2017 Act: (i) was the 2017 Act subject to the Bankruptcy Clause's uniformity requirement; and (ii) if so, did Congress permissibly impose non-uniform fees under the 2017 Act.

Writing for a unanimous Court, Justice Sotomayor began her analysis by looking to the text of the Bankruptcy Clause, which empowers Congress to enact "uniform laws on the *subject of Bankruptcies* throughout the United States." The Court emphasized that the phrase "the subject of Bankruptcies" has historically been interpreted to give Congress nearly plenary power to enact both substantive and administrative bankruptcy laws. In this case, because "[t]he only 'subject' of the 2017 Act is bankruptcy," and the 2017 Act clearly "affect[ed] the 'substance of debtor-creditor relations,'" the 2017 Act was clearly a law "on the subject of Bankruptc[y]," and was therefore plainly subject to the Bankruptcy Clause's uniformity requirement.

The Court then analyzed whether the 2017 Act was a permissible exercise of the Bankruptcy Clause's uniformity requirement. Relying on precedent, the Court explained that the uniformity requirement of the Bankruptcy Clause "is not a straitjacket" and affords Congress some "flexibility to craft legislation that responds to different regional circumstances that arise in the bankruptcy system," but is not "toothless" and "does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography." Instead, "'[t]o survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors.'" (quoting *Railway Labor Executives Association v. Gibbons*, 455 U.S. 457, 473 (1982)). Here, it was undisputed that the 2017 Act's fee increase was not geographically uniform.

Thus, the Court turned to the final issue: whether the non-uniform application of the 2017 Act could nevertheless withstand judicial scrutiny because it was a permissible response to a geographically isolated problem. The 2017 Act's fee increase was legislated to combat a deficit in the UST fund, which funds the Trustee Program, but not the Administrator Program. Although the UST fund deficit had a geographic dimension, in that it only affected Trustee Program districts, this geographic disparity did not result from "an external and geographically isolated need, but from Congress' own decision to create a dual bankruptcy system funded through two different mechanisms in which only districts in two States could opt into the more favorable fee system for debtors." As a result, the Court held that the 2017 Act's fee increase violated the Bankruptcy Clause's uniformity requirement.

The Court's opinion made clear that its holding in *Siegel* is narrow and does not address the constitutionality of the dual scheme of the bankruptcy system, nor does it impair Congress's authority to structure relief differently for different classes of debtors based on geographically isolated problems in the future.

Third Circuit Proclaims Future Claims Representative Appointment Standard

In re Imerys Talc. Am., Inc., No. 20-3485, 2022 WL 2350264 (3d Cir. June 30, 2022)[1]

On June 30, 2022, the United States Court of Appeals for the Third Circuit resolved several decades' worth of uncertainty by establishing a standard to be used for the appointment of future claimants' representatives in bankruptcy cases involving section 524(g) of the Bankruptcy Code. The case, *In re Imerys Talc Am*., *Inc*., concerned the opposition of certain insurer parties in interest to the proposed appointment of James L. Patton, Jr., a partner at the law firm of Young Conaway Stargatt & Taylor, LLP, as the future claimants' representative. The Insurers argued that Mr. Patton should be disqualified from service as the FCR due to Young Conaway's concurrent representation of two of the Insurers, Continental Casualty Company and National Union Fire Insurance Company of Pittsburgh, PA, in unrelated litigation pending before the Delaware Superior Court (the "**Warren Pumps Litigation**").[2]

Imerys Talc America, Imerys Talc Vermont, Inc., and Imerys Talc Canada Inc. commenced bankruptcy proceedings in the United States Bankruptcy Court for the District of Delaware on February 13, 2019. The Debtors were motivated to seek chapter 11 protection in part by an urgent need to resolve substantial potential liabilities as a result of thousands of claims by plaintiffs alleging personal injuries caused by exposure to talc mined, processed, and/or distributed by one or more of the Debtors. The Warren Pumps Litigation involved insurance coverage disputes related to environmental liabilities (including asbestos claims) that were resolved by the Delaware Supreme Court in 2016. By the Petition Date, the Warren Pumps Litigation had been resolved except for negotiation of the provisions of a "Final Judgment Order" consistent with the directives of the Delaware Superior Court.

Two weeks after the Petition Date, the Debtors filed a motion to appoint Mr. Patton as the FCR in the chapter 11 cases. This motion was accompanied by a declaration from Mr. Patton disclosing, among other things, Young Conaway's representation of Continental and National Union in the Warren Pumps Litigation. Despite this early disclosure, many months would pass before Chief Judge Silverstein, *not* the Insurers, first raised the issue of the potential conflict of interest. Thereafter, in supplemental disclosures, Young Conaway disclosed (i) that the firm's engagement letter with Continental and National Union had included a prospective bankruptcy waiver and (ii) that Young Conaway had established an ethical wall between attorneys working on the Imerys bankruptcy proceedings and those involved in the Warren Pumps Litigation. Only upon receipt and review of these supplemental pleadings did the Insurers object to Mr. Patton's proposed appointment as FCR as a concurrent conflict of interest given the Warren Pumps Litigation. The Bankruptcy Court ultimately overruled the Insurers' objections, finding that the waiver was valid and approving Mr. Patton's appointment as FCR and his retention of Young Conaway as his counsel. The District Court affirmed and the Insurers appealed to the Third Circuit.

The Third Circuit's opinion began by addressing the issue of whether the four Insurers (the

[1] Young Conaway serves as counsel to James L. Patton, Jr., in his capacity as legal representative for Future Talc Personal Injury Claimants in the *Imerys* chapter 11 cases.

[2] *See Viking Pump, Inc. and Warren Pumps LLC v. Century Indemnity Co., et al.*, C.A. No. N10C-06-141 (PRW) (Del. Super. Ct.).

"**Remaining Insurers**") who were not Young Conaway clients had standing to sue given that they would not be prejudiced by Mr. Patton's appointment.[3] The Remaining Insurers alleged that they had standing to sue based on the standard articulated by the Court in *In re Congoleum Corp.*, 426 F.3d 675 (3d Cir. 2005) because the purported conflict of interest "implicate[d] the integrity of the bankruptcy proceeding as a whole."[4] The Third Circuit rejected this argument noting the absence of certain unique factors integral to the analysis in *Congoleum* and clarifying that standing in bankruptcy appeals is evaluated using the "person(s) aggrieved" standard set forth in *Travelers Insurance Co. v. H.K Porter Co., Inc.,* 45 F.3d 737 (3d Cir. 1995). Per *Travelers*, a "person aggrieved" has standing if a contested order "diminishes their property, increases their burdens, or impairs their rights."[5] Because the Remaining Insurers could not satisfy the "person(s) aggrieved standard," their claims were dismissed.

The Court next addressed the issue of whether the Insurers' failure to timely object to Mr. Patton's appointment constituted waiver. Although the Insurers were afforded adequate notice and ample time to raise their objection to Mr. Patton's appointment, they tactically elected to wait to raise the objection until months after the objection deadline had passed.[6] As a result, the record regarding what, if anything, Young Conaway might have learned in the Warren Pumps Litigation that could have compromised the Insurers' interests in the bankruptcy proceedings, was undeveloped. Ultimately, although the Court noted that the Insurers' delay could have operated to waive their objection, the Court elected to proceed to the merits of the parties' arguments because "the open legal questions in the case ha[d] significant implications for bankruptcy law" and the parties had fully briefed the issues.

Thus, the Court turned to the question of the proper standard to be used in the appointment of future claimants' representatives. Mr. Patton and Young Conaway urged the Court to adopt a "disinterested person" standard as defined by section 101(14) of the Bankruptcy Code, while the Insurers advocated for the adoption of a "guardian *ad litem* test." The Insurers also argued that, consistent with section 327 of the Bankruptcy Code, "any actual conflict of interest" held by a proposed future claimants' representative should be *per se* disqualifying. Ultimately, the Court determined that the proper standard "require[d] more than disinterestedness" and adopted the "guardian *ad litem*" standard used by the Bankruptcy Court.[7] Under this approach, a proposed future claimants' representative "must be able to act in accordance with a duty of independence from the debtor and other parties in interest in the bankruptcy, a duty of undivided loyalty to future claimants, and an ability to be an effective advocate for the best interests of the future claimants."

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[3] The Court noted that National Union and Continental clearly had standing to sue due to the purported concurrent conflict of interest.

[4] *In re Congoleum Corp.*, 426 F.3d 675, 685-86 (3d Cir. 2005).

[5] *Travelers Ins. Co. v. H.K. Porter Co., Inc.*, 45 F.3d 737, 742 (3d Cir. 1995).

[6] In fact, a subset of the Insurers filed a different limited objection to Mr. Patton's appointment as FCR based on his prepetition engagement as the proposed FCR on the theory that this engagement "raised questions about [Mr. Patton's] independence from Imerys."

[7] The Court clarified that the adoption of this standard did not transform the future claimants' representative into an actual guardian *ad litem* for future claimants because, among other things, "true guardians *ad litem* have the legal authority to bind those they represent" while the future claimants' representative "merely participates in the negotiation of a plan and channeling injunction that will govern its constituents' future claims." Instead, what the Third Circuit adopted is "merely a standard *akin* to those employed for guardians *ad litem* in other contexts."

The Court's opinion sets forth the reasoning behind the adoption of this standard in detail. First, the Court looked to the text and structure of the Bankruptcy Code. The Court noted that section 524(g) does not reference the "disinterested person" standard, but instead refers to the future claimants' representative as a "legal representative," suggesting that he or she will serve as a fiduciary to the future claimants and will owe future claimants more than disinterestedness. Next, the Court analogized the FCR to a "creditors' committee of one," explaining that just as the creditors' committee is required to be free of conflicts of interest and to fulfill fiduciary duties to its constituents, an FCR too must not have conflicts of interest and must fulfill fiduciary duties to the future claimants. Finally, the Court rejected the Insurers' request that the Court adopt a framework providing for *per se* disqualification of a proposed FCR, stating "the mere existence of a technical conflict" should not disqualify a proposed FCR so long as the bankruptcy court can conclude that he or she will fulfill "the duties of independence and undivided loyalty and will serve as an effective advocate for the future claimants."[8]

Finally, the Court addressed the propriety of Mr. Patton's appointment as FCR in light of the alleged conflict of interest. The Court noted that Mr. Patton's "qualifications, independence, undivided loyalty, or ability to be an effective advocate for future claimants," had not been questioned by the Insurers or the Bankruptcy Court. Instead, the only allegation that Mr. Patton's appointment might be improper stemmed from the purported ethical conflict arising from Young Conaway's work in the Warren Pumps Litigation. To this end, the Insurers argued that the Warren Pumps Litigation created a direct conflict of interest between Mr. Patton and Continental and National Union, and that Young Conaway's involvement in the Warren Pumps Litigation tainted Mr. Patton's independence and jeopardized his ability to advocate for the interests of the future claimants.

The Court rejected the allegations of a direct conflict of interest, agreeing with the Bankruptcy Court that the prospective waiver contained in Young Conaway's engagement letter with National Union and Continental had disposed of the issue. In like fashion, the Court rejected the argument that Mr. Patton's independence would be compromised by the conflict of interest because the Insurers had failed to show that the Warren Pumps Litigation involved the same transactions or legal disputes. Moreover, the Court noted that Young Conaway's supplemental disclosures regarding Mr. Patton's proposed appointment revealed that Young Conaway had implemented an ethical wall between its work on the Warren Pumps Litigation and Mr. Patton's work as proposed FCR in *Imerys*, and that Mr. Patton had never been involved with the Warren Pumps Litigation. As a result, the Court agreed with the Bankruptcy Court that Mr. Patton would serve the future claimants' interests with the requisite independence and loyalty demanded by his position as FCR.

[8] Notably, the Third Circuit did not prescribe any particular process a bankruptcy court must undertake to appoint a future claimants' representative. Instead, the Court explained that so long as the bankruptcy court utilizes a process that "ensures that the court has the information necessary to assess the candidate(s)'s qualifications. . . variations in the appointment process are otherwise within the discretion of the bankruptcy court."

The Third Circuit Clarifies Rules of Professional Conduct Do Not Need to be Considered Before a "Conflict" Analysis Under Section 327 of the Bankruptcy Code

In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643 (3d Cir. May 24, 2022)[1]

On May 24, 2022, the United States Court of Appeals for the Third Circuit affirmed the rulings of the Delaware District Court and Delaware Bankruptcy Court that Sidley Austin LLP did not violate section 327 of the Bankruptcy Code when it concurrently represented both the Boy Scouts of America ("**BSA**") and a collective of BSA's liability insurers. In reaching its conclusion, the Third Circuit declined to adopt a new rule obligating courts to consider applicable provisions of the Rules of Professional Conduct *before* issuing a judgment on whether Section 327 was satisfied. Rather, the Third Circuit held that professional rules are distinct and should be considered separately from Section 327, although they may be informative depending on the facts.

In September 2018, Sidley was retained by BSA to explore restructuring options. Shortly thereafter, Sidley was hired by one of BSA's insurers, Century Indemnity Co., Westchester Fire Insurance Co., and Westchester Surplus Lines Insurance Co. (together, "**Century**") to represent it in certain unrelated reinsurance disputes. Although BSA made claims and obtained recoveries under its insurance policy with Century, Sidley was not involved in those matters because BSA secured separate representation for insurance coverage issues. Similarly, Sidley was also not involved with Century's dealings with BSA. Notwithstanding, Century grew dissatisfied with the arrangement and opposed Sidley's request for retention in BSA's bankruptcy case, claiming Sidley had a conflict under Section 327. Century's objection only concerned the ability of Sidley to represent BSA, and the Bankruptcy Court determined that Sidley could do so effectively, thus approving its retention. The District Court affirmed, and Century appealed to the Third Circuit.

Because the emphasis of Section 327 is on the estate, the Third Circuit focused its analysis on whether Sidley could effectively represent BSA in its bankruptcy case, not whether Sidley could effectively represent Century in its reinsurance matters. Since Sidley's relationship to Century did not affect its ability to advocate on behalf of BSA, the Third Circuit concluded that there was not an "actual conflict" under Section 327. The Court rejected Century's argument that the Rules of Professional Conduct should always be considered before analyzing Section 327 and elected not to review them here. It found that the Rules of Professional Conduct "impose independent obligations" that must be analyzed separately, although they may be "consulted" at times. The Third Circuit affirmed the lower courts' rulings that regardless of whether Sidley had violated a professional responsibility rule, disqualification on that sole basis would be inappropriate because the alleged conflict did not bring any actual harm to Century, whereas disallowing Sidley to be retained would significantly disadvantage BSA.

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[1] Young Conaway serves as counsel to James L. Patton, Jr., in his capacity as legal representative for Future Abuse Claimants in the *BSA* chapter 11 cases.

Third Circuit Chides Counsel's "Chutzpah" After Counsel's Lack of Candor to the Court and Adequate Disclosure Involving Fees

In re 38-36 Greenville Ave, LLC, 2022 WL 1153123 (3d Cir. 2022)

In *In re 38-36 Greenville Ave, LLC,* the United States Court of Appeals for the Third Circuit emphasized the need for candor to the court and adequate disclosure involving fee arrangements. In the context of a dispute regarding a bankruptcy court's jurisdiction over fee disgorgement, the Third Circuit addressed "repeated violations of the Bankruptcy Rules and the Code" by debtor's counsel who deliberately withheld information regarding fee payments he received from a debtor's estate. Upholding the bankruptcy court's order requiring debtor's counsel to disgorge such payments, the Third Circuit signaled that bankruptcy attorneys who have egregiously violated the bankruptcy rules and code by, for example, failing to disclose the receipt of prepetition payments, will not be rewarded for ignoring longstanding case law establishing a bankruptcy court's authority to impose reasonable disciplinary action for such actions.

Penalty for Failure to Maintain Health Insurance Coverage Under the Patient Protection and Affordable Care Act Is Entitled to Priority Under Section 507(a)(8) of the Bankruptcy Code

In re Szczyporski, 34 F.4th 179 (3d Cir. 2022)

On May 11, 2022, in *In re Szczyporski*, the United States Court of Appeals for the Third Circuit held that the individual mandate under the Patient Protection and Affordable Care Act ("**ACA**") for those who fail to maintain required health insurance coverage is a tax for bankruptcy purposes, entitled to priority under section 507(a)(8) of the Bankruptcy Code.

The Third Circuit's decision follows the U.S. Supreme Court's ruling in *NFIB v. Sebelius*, 132 S.Ct. 2566 (2012), which established that the payment for failing to maintain insurance coverage under the ACA is a tax for constitutional purposes. After determining that *Sebelius* was only a persuasive—and not determinative—factor in assessing whether a payment is a tax for bankruptcy purposes, the Third Circuit endorsed a flexible balancing test that requires a court to consider six factors, among others, including: whether a payment is (1) an involuntary pecuniary burden; (2) imposed by or under authority of the legislature; (3) for public purposes; (4) under the police or taxing power of the state; (5) universally applicable to similarly situated entities; and (6) whether granting a payment priority status will disadvantage private creditors with similar claims. The Court emphasized that provisions deemed taxes for bankruptcy purposes should be viewed in light of "the evolving treatment of priority claims under the Bankruptcy Code." After applying the balancing test, the Court held, among other things, that the payment was a tax for bankruptcy purposes because it was in the nature of an "involuntary pecuniary burden" imposed by Congress under its taxing power, levied for a public purpose, and was universally applicable to all similarly situated taxpayers. In addition, the payment lacks "typical penal characteristics" as it "does not impose a heavy financial burden, has no scienter requirement, cannot be enforced through punitive means . . . and is not imposed for an unlawful act."

By interpreting Section 507(a)(8) by its plain language, the Third Circuit determined that the payment functions as a tax "measured by income," entitled to eighth-level priority, when a "payer's household income played an essential role in determining the amount owed.

Delaware District Court Affirms that *Acevedo* Does Not
Preclude Retroactive Retention

City of Rockford v. Mallinckrodt PLC (In re Mallinckrodt PLC), No. BR 20-12522-JTD, 2022 WL 906462 (D. Del. Mar. 28, 2022)[1]

In *City of Rockford v. Mallinckrodt PLC*, the United States District Court for the District of Delaware affirmed an order of the Delaware Bankruptcy Court that authorized the Debtors' *nunc pro tunc* retention of Arnold & Porter Kaye Scholer LLP, and in doing so, distinguished the U.S. Supreme Court's decision in *Catholic Archdiocese of San Juan v. Acevedo Feliciano*, 140 S. Ct. 696 (2020), by holding that *Acevedo's* bar on *nunc pro tunc* orders only applies in cases in which the deciding court had a jurisdictional defect—which was not the case here.

Subsequent to commencing their chapter 11 cases, the Debtors filed an application to employ and retain Arnold & Porter *nunc pro tunc* to the petition date under section 327(e) of the Bankruptcy Code. Arnold & Porter had previously represented the Debtors in litigation arising from the distribution, pricing, and marketing of Acthar Gel, the Debtors' primary specialty-branded product, and the Debtors had determined that it was critical for Arnold & Porter to continue to represent the Debtors while the chapter 11 cases were pending. Certain plaintiffs involved in the Acthar litigation (the "**Achtar Plaintiffs**") objected to the application, contending, among other things, that Arnold & Porter was not disinterested and that the Debtors had not satisfied the exceptional circumstances necessary for granting *nunc pro tunc* relief.

After a hearing, the Bankruptcy Court overruled the objection, and authorized the Debtors' retention of Arnold & Porter. In deciding that *nunc pro tunc* relief was warranted, the Bankruptcy Court rejected the Acthar Plaintiffs' suggestion that *Acevedo* applied. Instead, the Bankruptcy Court noted that *Acevedo* was "limited in scope and dealt with [the] use of a *nunc pro tunc* order to create jurisdiction where jurisdiction did not previously exist." The Acthar Plaintiffs appealed.

On appeal, the District Court affirmed the Bankruptcy Court's ruling. The District Court opined that the only factor of Section 327(e) at issue was the "adverse interest" factor, and Judge Stark held that the Debtors satisfied this prong because Arnold & Porter disclosed all necessary information to the Bankruptcy Court. Further, Judge Stark did not agree with the Acthar Plaintiffs' reliance on *Staiano v. Pillowtex, Inc.*, 304 F.3d 246, 250 (3d Cir. 2002), in support of their argument that Arnold & Porter held an adverse interest based on preference payments received. Rather, Judge Stark pointed to prior decisions holding that a pre-petition claim for unpaid professional fees arising from proposed special counsel's pre-petition representation of the debtor does not disqualify such counsel from representing the debtor under Section 327(e).

The District Court next reasoned that the Bankruptcy Court's approval of Arnold & Porter's *nunc pro tunc* retention was not an abuse of discretion. The District Court explained that Third Circuit precedent supports retroactive approval as long as prior approval would have been appropriate and any delay in seeking approval was due to hardship beyond the professional's control. Judge Stark further opined that the default rule in the Delaware Bankruptcy Court is to allow for *nunc pro tunc* relief and the U.S. Trustee will ordinarily not object to a retention application filed within 30 days

[1] Young Conaway serves as counsel to Roger Frankel, in his capacity as legal representative for Future Opioid PI Claimants in the *Mallinckrodt* chapter 11 cases.

of the petition date. Here, the District Court found that the Bankruptcy Court was well within its discretion to authorize retroactive approval, as the Debtors did not unduly delay in seeking Arnold & Porter's retention.

Finally, the District Court was not persuaded by the Acthar Plaintiffs' broad claim that *Acevedo* gutted bankruptcy courts of their authority to retroactively approve the retention of professionals. Pointing to precedent in other courts and the Delaware Bankruptcy Court, Judge Stark explained that *Acevedo* is distinguishable, as it simply reiterates the well-understood distinction between a court creating jurisdiction where none exists and granting retroactive relief on equitable grounds when the court indisputably has jurisdiction to act. Pointing to Third Circuit precedent, Judge Stark explained that a court may generally grant *nunc pro tunc* relief as justice may require and that with respect to Section 327(e) in particular, retroactive compensation is not only permissible (as it is actually incorporated into the Federal Rules of Bankruptcy Procedure), it is practically required.

COVID-19 Pandemic Serves as Unforeseen Business Circumstance and Natural Disaster for Purposes of WARN Act Exceptions

In re Art Van Furniture, LLC, 638 B.R. 523, 529 (Bankr. D. Del. 2022)

In *In re Art Van Furniture, LLC (Stewart v. Art Van Furniture, LLC)*, now-former Judge Sontchi of the United States Bankruptcy Court for the District of Delaware granted the chapter 7 trustee's motion for summary judgment in an adversary proceeding brought by former employees, reasoning that COVID-19 satisfied the unforeseen business circumstance and the natural disaster exceptions to the Federal Worker Adjustment and Retraining Notification Act ("**WARN Act**") and justified Art Van's issuance of a second notice of termination with a shortened notice period.

Before filing for bankruptcy protection, Art Van defaulted on its asset-backed loan and obtained a forbearance on its term loan. The forbearance afforded Art Van an opportunity to find a buyer, an investor, or to otherwise recapitalize the business. Art Van was unable to achieve any of those objectives and decided to liquidate. To that end, the company negotiated a wind-down budget with one of its preexisting lenders, hired a liquidator, and issued notice to its employees, pursuant to the WARN Act, that they should expect to be terminated within 60-74 days. On March 8, 2020, Art Van and certain of its affiliates filed chapter 11 petitions. The Debtors planned to sell a portion of their furniture store locations, which would continue to operate post-sale under the new owner. The rest of the Debtors' stores would cease to operate.

On March 13, 2020, the COVID-19 outbreak was declared a national emergency, which resulted in government orders to shut down businesses and to put states on lockdown in an effort to contain the virus. Consequently, Art Van's deposits from store closing sales fell to $8 million in the week ending March 18, 2020, down from $23 million in the first week of the sales. On March 19, 2020, the Debtors issued a second WARN letter providing that employees would be terminated within 1-3 days depending on employees' functions, citing the impact of COVID-19 and the resulting sudden, negative economic impact on the Debtors as the basis for the change in termination date. By March 23, 2020, several of the states where the Debtors operated ordered business shut downs. Shortly thereafter, the Debtors' lender terminated the use of cash collateral and the chapter 11 cases were converted to cases under chapter 7 of the Bankruptcy Code.

Certain former employees filed an adversary proceeding alleging that Art Van violated the WARN Act by failing to provide at least 60 days' notice of employee terminations. The Chapter 7 Trustee moved for summary judgment, arguing, among other things, that both the unforeseen business circumstance exception and the natural disaster exception in the WARN Act prevented a finding that the Debtors violated the WARN Act.

The Court found that both exceptions applied to the facts of the case. The Court stated that the unforeseen business circumstance exception should be evaluated objectively and at the time the decisions were made. While the Debtors were in dire financial straits leading up to the petition date, the Court determined that "COVID-19 was the proverbial 'straw that broke the camel's back' and caused the March 20, 2020 layoff[,]" rejecting the employees' argument that COVID-19 was merely a pretext for the mass layoffs. Moreover, the Court concluded that the second WARN letter issued on March 19, 2020 provided sufficient explanation for the shortened notice. The Court also found that COVID-19 qualified as a natural disaster and was the immediate cause of the layoffs. The evidentiary record substantiated these findings such that there was no basis to find that there was a dispute as to a material fact. Accordingly, summary judgment was granted in favor of the Chapter 7 Trustee.

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Delaware Bankruptcy Court Finds Breach of Fiduciary Duties by
Board and Majority Lender

Youngman. v. Yucaipa Am. All. Fund I, L.P. (In re ASHINC Corp.), No. 12-11564 (CSS), 2022 WL 1302514 (Bankr. D. Del. May 2, 2022)

In a lengthy opinion following years of litigation, now-former Judge Sontchi of the United States Bankruptcy Court for the District of Delaware found that (i) the board of directors of ASHINC Corp. ("**Allied**") breached fiduciary duties by deferring to Allied's majority first lien lender, Yucaipa, and refusing to engage in negotiations with a potential purchaser, Jack Cooper Transport ("**JCT**"); and (ii) Yucaipa also breached fiduciary duties to Allied's creditors by negotiating a premium price with JCT for the purchase of Yucaipa's debt, to the detriment of Allied's minority secured lenders; but that (iii) the Allied estates' litigation trustee did not prove damages arising from the breach.

In 2005, Allied entered its first bankruptcy, emerging in 2007 with Yucaipa's sponsorship. Following consummation of the plan of reorganization confirmed in Allied's first bankruptcy (the "**2007 Plan**"), Yucaipa held approximately 67% of Allied's new equity and the majority of Allied's first and second lien secured debt. The 2007 Plan also granted Yucaipa governance rights, including the right to appoint three members of Allied's five-member board of directors. Additionally, the 2007 Plan gave Yucaipa the right to select Allied's CEO, who would serve as the fourth member of the board. Finally, the 2007 Plan gave the creditors committee the right to select the fifth member of the Board, which selection had to be "reasonably acceptable" to Yucaipa.

After several informal overtures, in May 2011, JCT (a competitor) approached Allied's board regarding a potential asset purchase transaction. Instead of considering the offer, the board declined to engage in negotiations and directed JCT to negotiate directly with Yucaipa. JCT then began negotiations with both Yucaipa and Black Diamond and Spectrum (together, "**BD/S**", who were large minority holders of Allied's secured debt), to purchase their first lien debt, which it would later use to credit bid for Allied's assets. Over the course of these negotiations, BD/S became aware that Yucaipa was demanding a premium for its debt while JCT's offer to BD/S was at a discount. During trial, the Court found, throughout the parties' negotiations, that "any increase in Yucaipa consideration led to a concomitant drop in consideration to BD/S." BD/S confronted Yucaipa regarding the discrepancy and demanded equal and ratable treatment, but no agreement was ever reached. Eventually, negotiations between BD/S and Yucaipa broke down and BD/S filed an involuntary Chapter 11 petition against Allied on May 17, 2012, to which Allied ultimately consented.

In December 2013, JCT acquired Allied for $135 million in a sale under section 363 of the Bankruptcy Code. Before confirmation of Allied's plan, the official committee of unsecured creditors and BD/S each commenced an adversary proceeding against Yucaipa. Each adversary proceeding alleged, among other things, that the board and Yucaipa breached their fiduciary duties resulting in damages in excess of $158 million (representing the difference between the consideration set forth in an early term sheet and the ultimate purchase price JCT paid for Allied's assets). Following confirmation of Allied's plan in 2015, the Allied estates' litigation trustee stepped into the shoes of each of the plaintiffs. The Court addressed many of the claims raised in the adversary proceedings via pretrial dispositive motions in early 2021. In March 2022, the Court held a trial to address the remaining claims, which included breach of fiduciary duties.

The Court found that Allied was insolvent beginning in 2008. Under Delaware law, the fiduciaries of an insolvent corporation owe fiduciary duties "to the corporation for the benefit of all of its residual claimants . . . includ[ing] creditors." Accordingly, the Court held that Allied's board of directors and Yucaipa, as controlling shareholder, owed fiduciary duties to Allied and its creditors, including BD/S.

The Court held that "Yucaipa breached its fiduciary duties in its negotiations with JCT because it was seeking a higher price for its debt than that offered to BD/S" and other first lien creditors, instead of using its position to get a better deal on equal terms for all of Allied's creditors. Yucaipa used its control over Allied "as bargaining power that reflected 'inappropriate favoritism' to Yucaipa as the controlling shareholder." Yucaipa argued that its fiduciary duty was not implicated by the JCT negotiations because JCT was buying Allied's debt from Yucaipa, not Allied's assets. The Court rejected this argument. Judge Sontchi found that JCT was "a committed suitor that had been pursuing Allied for years," and had offered to purchase Allied's assets through a section 363 sale. However, rather than "us[ing] its control to initiate a process to lock in a lucrative transaction on equal terms for Allied's lenders," Judge Sontchi found that Yucaipa exploited its control over Allied "to receive a premium price for its First Lien debt to the detriment of other First Lien lenders." The Court also rejected Yucaipa's argument for the application of the business judgment rule, stating that "an entire fairness standard of review is appropriate where the controlling stockholder has actually used its power over the corporation 'to impair the normal and primary protection the law affords the corporation and its stockholders; the judgment of its independent board of directors.'" Finding that Yucaipa had not taken steps to ensure fairness to the minority equity holders, the Court concluded that the transaction, although never consummated, failed the test for entire fairness.

The Court held that Allied's board members also breached their fiduciary duties by deferring to Yucaipa and neglecting to engage in negotiations when JCT approached the company regarding an asset purchase transaction.

Despite finding that both Yucaipa and Allied's board breached their fiduciary duties, the court did not award the litigation trustee damages. Judge Sontchi explained that the litigation trustee's "damages case is unreasonable, arbitrary, and flawed for a number of reasons, including, without limitation, the use of the December 2011 term sheet, which was highly contingent and was clearly used by plaintiffs' expert solely to maximize damages, and the unreasonable assumption of only $5 million in bankruptcy fees to consummate a pre-negotiated sale in bankruptcy.

Delaware Bankruptcy Court Discusses Standard for
Payment of Nonparty's Discovery Costs

Mesabi Metallics Company v. Cleveland-Cliffs (*In re Essar Steel Minn. LLC*), Adv. Pro. No. 17-51210 (CTG) (Bankr. D. Del. May 23, 2022) [Adv. D.I. 585][1]

On May 23, 2022, Judge Goldblatt of the United States Bankruptcy Court for the District of Delaware issued a letter opinion in *Mesabi Metallics Company v. Cleveland-Cliffs*, asserting that, under Federal Rule of Civil Procedure 45, a party issuing a subpoena must bear the reasonable costs incurred by a nonparty in complying with the subpoena if the costs of compliance are significant.

Plaintiff Mesabi Metallics served a Rule 45 subpoena on U.S. Steel, seeking documents that Mesabi contended were relevant to the antitrust and business tort claims it was asserting against defendant Cleveland-Cliffs. U.S. Steel moved for a protective order, and Mesabi filed a motion to compel compliance with its subpoena.

Rule 45(d)(2)(B) provides, in relevant part, that if a nonparty objects to the issuance of a subpoena, the following rules apply: (1) at any time, on notice to the commanded person, the serving party may move for an order compelling production; and (2) the order compelling production, if issued, *must* protect the nonparty from *significant* expense resulting from compliance. Judge Goldblatt held that, in light of Rule 45 and a recent Third Circuit opinion, "cost-shifting appeared to be mandatory so long as the cost of complying with the subpoena would be 'significant.'" *Id.* (citing *R.J. Reynolds Tobacco v. Philip Morris, Inc.*, 29 F. App'x 880, 883 (3d Cir. 2002)). The Court concluded that the cost of complying with the subpoena was a significant cost for U.S. Steel given the costs had already exceeded $140,000.

The parties also disagreed as to whether the costs to be shifted should include attorneys' fees associated with reviewing documents for (a) responsiveness, (b) privilege, or (c) sensitive business information. Mesabi argued that costs related to efforts by a company to check for privileged information within its documents are not subject to cost-shifting under Rule 45.

The Court acknowledged that Rule 45 covers only expenses that are reasonably incurred to comply with a subpoena; wholly unnecessary or unreasonable costs may not be shifted to the party issuing the subpoena. The question became: is the cost of conducting document review before documents are produced reasonably incurred? The Court answered in the affirmative. Because U.S. Steel and Mesabi are in the same industry and are business competitors, it was reasonable for U.S. Steel to review its documents before producing them to Mesabi. Therefore, Judge Goldblatt ruled that Mesabi must bear the reasonable costs incurred by U.S. Steel in complying with Mesabi's subpoena, including the reasonable costs of reviewing the documents before their production.

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[1] Young Conaway serves as counsel to Cleveland-Cliffs in the *Mesabi Metallics Company v. Cleveland-Cliffs* matter.

Judge Dorsey Denies Summary Judgment Request to Permit Trustee to Conduct Discovery

Miller v. ANConnect, LLC (In re Our Alchemy, LLC), Adv. Pro. No. 18-50633 (JTD) (Bankr. D. Del. May 12, 2022) [Adv. D.I. 241]

On May 12, 2022, Judge Dorsey of the United States Bankruptcy Court for the District of Delaware denied defendant ANConnect LLC's motion for summary judgment in the case of *Miller v. ANConnect, LLC, (In re Our Alchemy, LLC)*, pursuant to Federal Rules of Civil Procedure 56(d).

Rule 56(d) permits a party faced with a motion for summary judgment to inform the court that additional discovery is needed to support its response. Courts generally grant Rule 56(d) motions as a matter of course when outstanding discovery requests or facts relevant to summary judgment are not in the hands of the responsive party. *Miller*, at *4-5 (quoting *Murphy v. Millennium Radio Grp. LLC*, 650 F.3d 295, 309-10 (3rd Cir. 2011)). Invoking Rule 56(d) requires the objecting party to identify, (1) which information is sought, (2) how it would preclude summary judgment, and (3) why it had not yet been obtained. *Id.* at *5.

The Liquidation Trustee alleged that the Debtors did not receive reasonably equivalent value from ANConnect when purchasing a portion of the defendant's business, resulting in the Debtors filing for bankruptcy less than a year after the purchase. ANConnect moved for summary judgment, arguing that evidence produced by the Liquidation Trustee defeated the claims. The Liquidation Trustee raised Rule 56(d) in opposition, claiming that issues of reasonably equivalent value require discovery, and that the defendant prevented him from obtaining that discovery. ANConnect claimed that further discovery was not necessary because (1) the discovery sought was outside the scope of the complaint, (2) the Liquidation Trustee already had all relevant information, and (3) the relevant information established that the deal was at arm's length, barring the Liquidation Trustee's claims.

The Court disagreed, holding that the requested discovery would provide insight into the value ANConnect placed on the acquired asset, as well as internal communications regarding the same. Judge Dorsey reasoned that while an arms-length transfer is one indication of reasonably equivalent value, it is not determinative; the good faith of the parties and the difference between market and paid values must also be considered. In denying the motion for summary judgment without prejudice, Judge Dorsey concluded that the Liquidation Trustee was entitled to obtain information through discovery that may shed light on the actual value of the defendant's business and the parties' internal communications about the underlying transaction

YOUNG CONAWAY

Judge Silverstein Confirms Mass Tort Debtor's Plan,
Including Third Party Releases of Non-Debtor Affiliates

In re Paddock Enterprises, Inc., Case No. 20-10028 (LSS) Hr'g Tr. (Bankr. D. Del. May 16, 2022)[1]

Judge Silverstein of the United States Bankruptcy Court for the District of Delaware recently confirmed the Debtor's plan in *Paddock Enterprises*, which resulted in full payment for asbestos creditors.

The events leading to the bankruptcy had been set in motion by Owens-Illinois, Inc. ("**Owens**"), which was burdened by its historic asbestos liabilities related to a line of asbestos products under the brand "Kaylo." Owens effected a corporate restructuring pursuant to section 521(g) of the Delaware General Corporation Law, which is similar to the "Texas Two-Step." Owens aimed to structurally separate its legacy liabilities from its subsidiaries' active operations, dubbing the restructuring the "Corporate Modernization Transaction." As a result of the transaction, Owens ceased to exist for corporate purposes under Delaware law and two new entities were created: (i) the Debtor, into which Owens merged, named "Paddock Enterprises", and (ii) the Debtor's parent, O-I Glass, Inc. ("**O-I Glass**"), a publicly traded company housing Owens's former operating subsidiaries.

Owens undertook the transaction on December 26-27, 2019, and the newly-formed Debtor filed for bankruptcy approximately ten days later. The Debtor's pre-filing actions drew the scrutiny of the U.S. Trustee, who moved to appoint an examiner for the case. Asbestos claimants' representatives were equally wary but nevertheless opposed the examiner motion. The claimants' representatives argued that an examiner's investigation would be duplicative of theirs, which was already underway. Moreover—but perhaps equally as important—the Debtor had promised from the outset that the bankruptcy would result in payment-in-full for asbestos claimants. The claimants' representatives wanted the opportunity to test this promise and negotiate "a plan and trust distribution procedures, which might obviate the need for costly, protracted litigation and better serve all parties in interest." The Court agreed with the claimants' representatives, denied the examiner motion, and afforded the parties an opportunity to negotiate a plan.

The parties made the most of the opportunity, mediated their disputes under the supervision of Ken Feinberg and ultimately agreed on a full-pay plan. As Judge Silverstein summarized:

> [T]he parties went away, and I didn't hear from the parties for a good year-plus, and came back with a 100-percent plan, exactly what the debtor said they wanted and promised at the beginning of the case, and a result that really nobody can have any issue with and exactly how this was supposed to work.

Under the Plan and pursuant to section 524(g) of the Bankruptcy Code, the Debtor and its non-Debtor affiliates will (i) channel all Kaylo-related asbestos claims to a trust and (ii) receive releases

[1] Young Conaway serves as counsel to James L. Patton, Jr., in his capacity as legal representative for Future Demand Claimants in the *Paddock* chapter 11 cases.

from the claimants. As consideration, O-I Glass will contribute $610 million to the trust, which will liquidate asbestos claimants in accordance with its distribution procedures.

The Plan received a 99.99% acceptance rate among the sole voting class, asbestos claimants, and received only one objection, which was filed by the U.S. Trustee. The U.S. Trustee's objection focused on the Plan's exculpation and third-party release provisions, both of which the trustee believed to be overbroad.

Regarding exculpation, the U.S. Trustee argued that the definition of "exculpated parties," which included the undefined term of the parties' "representatives," was overbroad and would immunize those who "wouldn't even qualify as fiduciaries." The Debtor and U.S. Trustee agreed to resolve this objection by ensuring that the confirmation order would not prejudge what potential "representatives" might be captured by the definition.

Regarding the releases, the U.S. Trustee concentrated on the lengthy list of over 200 non-Debtor affiliates, as well as those entities' representatives, to be released by third parties, arguing that these entities provided no consideration in exchange for the releases. The Court, however, recognized that O-I Glass could provide consideration on behalf of these persons/entities. In addition, the releases were limited in two other critical respects. First, the releases only related to conduct or actions connected to the Debtor. Second, the releases were consensual because the releasing parties (defined to include holders of claims that voted to accept the Plan, holders of unimpaired claims that were presumed to accept and did not file a timely objection, and holders of claims that voted against/did not vote and did not opt-out of the releases) received adequate notice and an opportunity to opt-out. Judge Silverstein reaffirmed her position—and the position of several other Delaware bankruptcy judges—that an opt-out mechanism provides sufficient notice for purposes of establishing a consensual release.

Confirmation of Chapter 11 Plans Involving South American Debtors

In re Alpha Latam Mgmt., LLC, Case No. 21-11109 (JKS) (Bankr. D. Del. Mar. 16, 2022) [D.I. 652]; *In re Alto Maipo Delaware LLC*, Case No. 21-11507 (KBO) (Bankr. D. Del. May 13, 2022) [D.I. 614]; *In re Corp Grp. Banking S.A.*, Case No. 21-10969 (JKS) (Bankr. D. Del. June 16, 2022) [D.I. 825]

Over the past four months, the United States Bankruptcy Court for the District of Delaware has successfully confirmed chapter 11 plans in three cases involving very large South American companies: *In re Alpha Latam Management LLC*, Case No. 21-11109 (JKS) (Bankr. D. Del. March 16, 2022); *In re Alto Maipo Delaware LLC*, Case No. 21-11507 (KBO) (Bankr. D. Del. May 13, 2022); and *In re Corp Group Banking S.A.*, Case No. 21-10969 (JKS) (Bankr. D. Del. June 16, 2022). Each case implicated complicated disputes governed by foreign law and predominantly Spanish-speaking creditors. The Delaware bankruptcy court successfully navigated these cases with global reach over the past several months, further strengthening its reputation as a court of both national and international preeminence, and solidifying the ability of foreign entities to obtain effective and orderly relief in Delaware.

In re Alpha Latam Management LLC, Case No. 21-11109 (JKS)[1]

The debtors in *Alpha Latam* and their non-debtor Mexican affiliates comprised a specialty finance company in Latin America that provided payday lending services, including greater access to credit, to the low-income segment of the Mexican population. The debtors included Colombian, Panamanian, and Mexican entities and a Delaware entity—Alpha Latam Management, LLC.

Prior to and during their chapter 11 cases, the Debtors conducted a sale and marketing process that culminated in the Delaware bankruptcy court's approval of the sale of the majority of the loan portfolio and operational assets of debtors Alpha Capital S.A.S. and Vive Créditos Kusida S.A.S. to CFG Partners Colombia SAS pursuant to section 363 of the Bankruptcy Code for approximately $149.5 million plus the assumption of certain liabilities. After the sale was approved, the debtors filed a chapter 11 plan that provided for the liquidation and dissolution of the debtors (except for Alpha Latam Management LLC) and the distribution of the asset sale proceeds and the proceeds of certain litigation. On March 16, 2022, Judge Stickles confirmed the debtors' plan over the U.S. Trustee's objection to the scope of the third party releases and various parties' objection to the payment of an ad hoc group's professional fees as administrative expenses as part of a settlement under the plan.

In re Alto Maipo Delaware LLC, Case No. 21-11507 (KBO)[2]

The debtors in *Alto Maipo* included a special purpose entity organized under the laws of Chile to construct and eventually operate a large run-of-river hydroelectric project in the Andes Mountains, approximately 30 miles southeast of Santiago, Chile. The project was designed to provide clean, renewable energy to power Chile's economy and to accelerate the decarbonization of Chile. The

[1] Young Conaway serves as co-counsel to a consortium of DIP note purchasers in the *Alpha Latam* chapter 11 cases.
[2] Young Conaway serves as co-counsel to the debtors in the *Alto Maipo* chapter 11 cases.

debtors filed a plan of reorganization that provided for (i) approximately $2.1 billion in restructured obligations, (ii) the exchange or payment of the up to $50 million DIP credit facility with the proceeds of an exit financing facility, and (iii) the unimpairment of general unsecured creditors.

On May 13, 2022, Judge Owens confirmed the debtors' plan over the objection of the U.S. Trustee to the scope of the plan's third party releases. In doing so, Judge Owens required the debtors to modify the definition of "related parties" so that they were only incorporated into the definition of releasing parties "to the extent the pertinent Releasing Party can bind any such Related Party to the terms of this Plan under applicable law."

***In re Corp Group Banking S.A.*, Case No. 21-10969 (JKS)**[3]

The debtors in *Corp Group Banking S.A.* are subsidiaries of, and controlled by, a conglomerate based in Chile, known as Corp Group. As of the petition date, the debtors' primary asset was their ownership of approximately 27.2% of the common equity of Itaú Corpbanca, a publicly traded Chilean bank (and a Securities and Exchange Commission registrant) controlled by Itaú. It is the fifth largest private bank in Chile and can be traced back to the creation of Banco de Concepción in 1871.

The debtors commenced their chapter 11 proceedings in an effort to liquidate their assets in a streamlined and orderly manner and distribute proceeds generated thereby to creditors, including by, among other things, (i) distributing the underlying collateral to each secured creditor in satisfaction of the debtors' secured obligations and (ii) distributing the debtors' unencumbered assets (consisting almost entirely of shares of Itaú Corpbanca) to the Debtors' unsecured creditors, including Itaú (in respect of its deficiency claim) and the holders of certain unsecured notes claim, on a *pro rata* basis. After extensive litigation with the Official Committee of Unsecured Creditors, among other parties, the liquidating plan ultimately confirmed by the Delaware bankruptcy court also approved a global settlement reached by and among the key constituencies in the chapter 11 cases. Among other things, the settlement contemplates a contribution of up to approximately $30 million by certain of the debtors' non-debtor affiliates over the next few years in exchange for broad third party and debtor releases.

Notably, Judge Stickles confirmed the debtors' plan over the U.S. Trustee's objection to the scope and nature of the debtor and third-party releases, finding that under the "unique circumstances" of the cases, there was no basis to exclude claims arising from or related to fraud, gross negligence or willful misconduct from claims released under the Plan.

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[3] Young Conaway serves as co-counsel to the debtors in the *Corp Group Banking* chapter 11 cases.

North Carolina District Court Affirms Bankruptcy Court Ruling
Approving Broad Injunctive Relief From Asbestos Claims

In re Bestwall LLC, 606 B.R. 243 (Bankr. W.D.N.C. 2019), *aff'd*, No. 3:20-CV-105-RJC, 2022 WL 68763 (W.D.N.C. Jan. 6, 2022)[1]

In the North Carolina case of Bestwall LLC, the North Carolina District Court recently affirmed broad injunctive relief from asbestos personal injury claims in favor of non-debtor Georgia Pacific.

Courts have long recognized that a plaintiff seeking relief in a federal court has the burden of proving jurisdiction. A bankruptcy court's jurisdiction is prescribed by Congress and limited by the Constitution. As recognized by the Supreme Court, a bankruptcy court, as a court created under Article I of the Constitution, does not have the authority to exercise the full judicial power of an Article III court. As it pertains to civil actions, a bankruptcy court's jurisdiction is narrow, only exercised where the action "arises in" or is "related to" the bankruptcy.[2]

"Related to" jurisdiction requires some possible effect on the bankruptcy estate. Under the *Pacor* test adopted by some jurisdictions, a proceeding is sufficiently "related to" a bankruptcy case if "the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy." *In re Celotex Corp.*, 124 F.3d 619, 625 (4th Cir. 1997) (citing *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)).

In July of 2017, through a corporate reorganization, arguably permitted by the Texas divisional-merger statute, Georgia-Pacific placed the majority of its asbestos liabilities in Bestwall and the majority of its assets into a "new" Georgia-Pacific. Bestwall did not come to bankruptcy to reorganize; instead, Bestwall exists as part of Georgia Pacific's strategy to obtain an injunction against asbestos personal injury claims without subjecting its assets and business operations to the court oversight, transparency, and creditor protections associated with the bankruptcy process. As part of its Texas divisional merger, Georgia-Pacific drafted agreements with no legitimate business justification other than to create the appearance that asbestos litigation against Georgia-Pacific would affect Bestwall's bankruptcy estate and thereby create jurisdiction. Bestwall is a shell company, with no true employees and no ongoing operations. It was made to absorb liabilities and file bankruptcy.

In most circuits, an action is "related to" a bankruptcy only if it will have an effect on the bankruptcy estate. Thus, courts most often find "related to" jurisdiction where a third-party action would have the effect of reducing or impairing the recovery for the debtor's creditors. In the absence of an effect on the bankruptcy estate, bankruptcy courts have no authority to enjoin, or otherwise interfere with, the rights of citizen-victims to pursue their claims against non-debtor tortfeasors in the state or federal judicial systems.

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[1] Young Conaway serves as counsel to Sander L. Esserman, in his capacity as legal representative for future asbestos personal-injury claimants in the *Bestwall* chapter 11 case.

[2] In a footnote, the District Court referred to "arising in" jurisdiction as a potential jurisdictional hook for the injunction, though the court did not decide whether "arising in" jurisdiction existed in this case.

Furthermore, parties are not allowed to artificially create their own jurisdiction. This limitation is found in 28 U.S.C. §1359, which prevents parties from assigning property and obligations to newly created entities to create jurisdiction where none previously existed. Bestwall was created and given contractual obligations in order to create jurisdiction in North Carolina. In its briefing, Bestwall even conceded as much, stating that it was created specifically to obtain bankruptcy relief for Georgia Pacific without subjecting it to bankruptcy, a clear violation of the statute.

Did the District Court err in determining that the Bankruptcy Court had jurisdiction to enjoin asbestos victims' claims against non-debtors when those claims would not affect the bankruptcy estate? The case has been appealed to the United States Court of Appeals for the Fourth Circuit to answer that very question.