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Discharging Future Asbestos Claims Without a Litigation Trust?

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The resolution of legacy mass tort liabilities through bankruptcy is one of the more complex challenges a debtor may face. Unlike normal trade obligations, mass tort claims, such as those arising from asbestos exposure, may involve a person whose injury has not yet manifested and thus, either was not aware that he or she holds a claim, or because no injury had manifested, not hold a claim that can be discharged. Following the landmark *Johns-Manville* case, Congress enacted Section 524(g) of the Bankruptcy Code, which sets forth a specific framework and, if followed, allows all asbestos liabilities to be channeled away from the debtor and into a trust designed to process and pay such claims. Among other things, Section 524 requires the appointment of a legal representative to represent future, unknown claimants and the creation of funded trusts to process such claims as they arise. But what if a debtor does not want to go through the added expense of retaining a future claims representative or otherwise follow the strict steps imposed by Section 524? Recently, the U.S. Court of Appeals for the Third Circuit addressed that very issue and highlighted the tricky and possibly dangerous road a debtor would have to follow. See *In re Energy Future Holdings*, 949 F.3d 806 (3d Cir. 2020).

In *Energy Future*, the court affirmed a confirmation order discharging latent asbestos claims, *i.e*., claims against the debtors for asbestos-related illnesses that did not manifest until after the bankruptcies, even though the debtors' plan did not satisfy the section 524(g) requirements. Picking up where it left off after *In re Grossman's*, 607 F.3d 114 (3d Cir. 2010) (en banc), the court recognized that establishing a litigation trust under Section 524(g) of the Bankruptcy Code for payment of latent asbestos claims is not the exclusive means for providing due process for unknown future claimants. According to the court, a plan like the one in *Energy Future* does not offend the Fourteenth Amendment of the U.S. Constitution by discharging latent asbestos claims if, for example, there is a fundamentally fair process for reinstating those claims post-confirmation.

The *Energy Future* debtors were EFH, a holding company, and its various subsidiaries. Four of the subsidiaries, to which the Third Circuit referred to as the asbestos debtors, were essentially liquidated because of their asbestos liability. Years later, EFH, the asbestos debtors and the other subsidiaries (collectively, the debtors) petitioned for relief under Chapter 11.

To inform unknown asbestos claimants of the deadline for filing proofs of claim—the "bar date"—the debtors implemented an extensive noticing procedure. It included publishing the bar date notice in 226 local and various other newspapers. The debtors' efforts paid off: Over 10,000 latent asbestos claimants filed proofs of claim.

While in Chapter 11, the debtors negotiated a merger between EFH and Sempra Energy, which would close upon the Bankruptcy Court's approval of the debtors' plan. As part of the transaction, Sempra would inherit the debtors' asbestos liability. Rather than establish a trust and channeling injunction for future asbestos claims pursuant to Section 524(g) of the Bankruptcy Code—the usual mechanism for a debtor with asbestos liability to handle future claims—the Chapter 11 plan discharged those claims, but future claimants could seek reinstatement pursuant to Bankruptcy Rule 3003(c)(3). Under that rule, the court may extend the bar date "for cause," which means that the movant must show that he or she missed the bar date because of "excusable neglect."

At confirmation, the Bankruptcy Court was satisfied that future claimants received proper notice of the bar date (albeit publication notice) and that rule 3003(c)(3)'s reinstatement procedures would protect future asbestos claimants' due process rights. The Bankruptcy Court confirmed the debtors' plan, and a group of latent asbestos claimants appealed. The district court, however, dismissed the appeal as moot, so the asbestos claimants took their case to the Third Circuit.

Judge Cheryl Krause, writing for the court, began the opinion by acknowledging bankruptcy procedure is ill-suited for litigating asbestos claims. She reasoned that the nature of asbestos-related illnesses is to blame: These diseases remain latent for many years and, therefore, a claimant may be unaware that he or she has a claim against a debtor's estate for which a proof of claim must be filed. But deadlines in bankruptcy, such as the bar date, are strictly enforced. Failure to file a proof of claim by the bar date generally allows the debtor to discharge the claim through a plan of reorganization. While enabling the debtor's "fresh start," these procedures infringe on latent asbestos claimants' due process rights by depriving them of their day in court—without prior notice and a hearing.

Krause explained, however, that, during the height of asbestos-driven bankruptcies, one court devised an "innovative and unique" way to balance the competing interests of debtors and future asbestos claimants: litigation trusts. Funded by debtors, the trusts would pay asbestos claimants as they became sick. And to protect the reorganized debtor, there would be an injunction in place channeling all asbestos claims to the trust. In the Third Circuit's opinion, Krause noted that "the *Manville* trust" (named after the case in which it was born) and related procedures worked so well that Congress codified them in Section 524(g) of the Bankruptcy Code.

Next, Krause considered the court's own precedents addressing asbestos liability in bankruptcy. *Grossman*'s featured prominently in that discussion. There, the court held that: an asbestos claim accrues at the time of exposure and not at the time of injury, which was the law in the Third Circuit before *Grossman*'s; and latent asbestos claims are dischargeable in bankruptcy if the discharge "comported with due process." In *Grossman*'s, the court listed several factors that may be assessed to determine whether the discharge comported with due process, including "whether it was reasonable or possible for the debtor to establish a trust for future claimants as provided by Section 524(g)."

Before addressing the due process issue, Krause explained that the court rejected all the debtors' various theories on why the court should not decide the substantive merits of the appeal—except for statutory mootness. Even then, the court determined that statutory mootness only barred one of the two due process arguments asserted by the latent asbestos claimants. Thus, the court held that it was able to rule on whether the reinstatement procedures under Rule 3003(c)(3) afford due process. (And a ruling on whether and under what circumstances a debtor must direct future asbestos claims to a Section 524(g) trust was left for another day.)

According to the court, reversal of the confirmation order on the basis that it was facially unconstitutional required the latent asbestos claimants to show that they were deprived of "life, liberty, or property," *i.e.*, interests protected by the Fourteenth Amendment, and the procedures available to the claimants did not "provide due process of law." The court readily determined that the latent asbestos claimants showed that they were deprived of an interest protected by the Fourteenth Amendment: Their ability to pursue asbestos claims was a property interest under the due process clause. Assessment of the available procedures, however, required more deliberation. After considering whether the procedures allowed for notice and a hearing, which the court held that they did, the court ruled in the debtors' favor.

It was undisputed that the latent asbestos claimants received publication notice of the bar date, and the court held that such notice was sufficient. Perhaps the most compelling evidence of proper notice was that 10,000 similar claims were filed by the bar date. Having determined that the publication notice passed constitutional muster, the court then turned to the post-confirmation hearing available to the claimants and evaluated whether they would have a fair opportunity to seek reinstatement. In other words, would latent asbestos claimants have the opportunity to satisfy the "excusable neglect" standard under Bankruptcy Rule 3003(c)(3)?

According to the court, the answer to that question was "yes."

To obtain reinstatement, a claimant must show that the danger of prejudice to the debtor is low, the claimant had good reason for the delay, and the length of the delay will not seriously impede the efficiency of the proceedings. Krause explained that the latent asbestos claimants had the opportunity to show all those elements: First, the asbestos claimants could point to the plan and Sempra merger as demonstrating lack of prejudice to the debtors because they expressly contemplated that asbestos claimants would utilize Bankruptcy Rule 3003(c)(3) to reinstate their claims. Second, the latent claimants could argue that the notice of the bar date failed to comport with due process and, as a matter of law, that would be a good reason for their delay. And third, notwithstanding the significant passage of time between the occurrence of the bar date and filing of reinstatement motions, that delay would have no impact on the debtors' bankruptcy cases because they were effectively over.

Therefore, the court held that the reinstatement procedures afforded due process.

At the end of the opinion, Krause referred to the case as a "cautionary tale for debtors attempting to circumvent Section 524(g)." Indeed, by forgoing a litigation trust, the debtors ultimately incurred the expense and inefficiencies they were trying to avoid. But the case has far more serious implications for latent asbestos claimants, especially those whose exposure was second hand. Holders of latent claims arising from second-hand exposure to asbestos may not realize they were exposed until decades after the debtor responsible exited Chapter 11. Thus, it would be reasonable for those claimants to ignore the bar date even if they received constructive notice.

Under *Energy Future*, however, a debtor could discharge such latent asbestos claims through a plan of reorganization, and a claimant's only recourse would be filing a motion for reinstatement of his claim pursuant to Bankruptcy Rule 3003(c)(3). (It seems, however, that the courthouse door remains open for "as-applied" constitutional challenges.) The reinstatement motion could be contested and denied. At that point, a claimant suffering from grave injury would be barred from ever seeking redress—a very harsh yet avoidable result.

In its reasoning, the court implied that there were sufficient monies available to pay any claims that were originally discharged but subsequently allowed under Rule 3003. Whether that assumption proves correct remains unclear. Further, if other jurisdictions do not follow the *Grossman*'s decision and find that latent claims are not subject to discharge, there could be another path for such claimants to file for recovery against the reorganized debtor or its successor. Time will tell.

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