

Pratt's Journal of Bankruptcy Law

AN A.S. PRATT & SONS PUBLICATION

JANUARY 2014

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ISBN 978-0-76987-846-1

Third Circuit Affirms Decisions Broadly Applying Section 524(g) Injunction To Claims

JASON HARBOUR, TARA ELGIE, AND MATTHEW MANNERING

The authors of this article discuss a recent U.S. Court of Appeals for the Third Circuit decision confirming that a channeling injunction pursuant to 11 U.S.C. § 524(g) may apply to all asbestos-related actions against a debtor.

The U.S. Court of Appeals for the Third Circuit recently confirmed that a channeling injunction pursuant to 11 U.S.C. § 524(g)¹ may apply to all asbestos-related actions against a debtor, including contribution and indemnity claims by defendants that are subjected to lawsuits for failure-to-warn brought by plaintiffs allegedly harmed by a debtor's asbestos-related business or products.² The Third Circuit also concluded that the contribution and indemnity claims were substantially similar to the direct personal injury asbestos claims such that classification of those claims in the same class did not run afoul of the plan classification requirements of 11 U.S.C. §1122(a). In addition, the Third Circuit held that the Joint Plan of Reorganization (the "Plan") did not provide disparate treatment among claims in the same class, even though direct and indirect asbestos claimants did not receive precisely equivalent treatment under the Plan, and that the channeling injunction under Section 524(g) was fair and equitable to claim-

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ants. The Third Circuit's decision reiterates the ability of debtors to receive expansive channeling injunctions under appropriate circumstances.

CASE BACKGROUND

W.R. Grace & Co.³ manufactured and sold chemicals for over 100 years before facing asbestos-related lawsuits in the 1970s. By 2001, W.R. Grace & Co. was facing approximately 65,000 lawsuits related to asbestos. The amount of suits and the magnitude of the damages sought became a threat to W.R. Grace & Co.'s financial well-being and, consequently, the company filed for protection under Chapter 11 of the United States Bankruptcy Code,⁴ seeking to use Section 524(g) to address the pending and future asbestos-related claims against the company by setting up a trust that would assume the asbestos liability.

After many years of negotiations regarding the structure and funding of the proposed channeling injunction and related trusts, W.R. Grace & Co., the personal injury creditors' committee, the future claimants' representative and the equity committee proposed the Plan. Central to the Plan was the establishment of two trusts⁵ — one for personal injury claims and one for property damage claims — that would assume all of W.R. Grace & Co.'s present and future asbestos-related liability.

The bankruptcy court held a 16-day confirmation hearing on the Plan and the numerous objections to confirmation. Two of the objecting parties were the State of Montana ("Montana") and Her Majesty Queen Elizabeth II in Right of Canada (the "Crown"), who asserted that their claims for contribution and indemnity for failure-to-warn could not be properly classified with the class of personal injury asbestos claims, that their claims were improperly subjected to the channeling injunction, and that their claims were unfairly treated under the Plan. On January 31, 2011, the bankruptcy court entered an order confirming the Plan and overruling the objections, including the objections of Montana and the Crown. Montana and the Crown appealed the confirmation to the district court. The district court determined that it was reasonable to include Montana and the Crown's indirect asbestos claims in the same class with direct asbestos claims, that the claims were correctly enjoined and channeled to the trust, and that there was no evidence that their claims received disparate treatment under the Plan.

THE THIRD CIRCUIT DECISION

Montana and the Crown argued to the Third Circuit that Section 524(g) is not applicable to their claims because their claims were not “claims” or “demands,” as those terms are used in Section 524(g), but rather the Crown and Montana asserted that their claims for contribution and indemnity were “requests.” In making this argument, the Crown and Montana asserted that their “requests” for contribution and indemnity could not be considered “claims” subject to Section 524(g) because their claims did not technically arise until a judgment or settlement had been paid, and as of the debtor’s petition date, no judgment had been entered against either the Crown or Montana. The Crown and Montana also argued that their “requests” were not “demands” because their requests for contribution and indemnity were not personal injury, wrongful death or property damage claims and therefore did not arise out of the same, or similar, conduct of the asbestos claims subject to the injunction as required by Section 524(g)(5)(B).

The Third Circuit rejected the arguments of the Crown and Montana that their claims were not “demands” or “claims.” The Third Circuit noted that the Bankruptcy Code “defines a ‘claim’ using the ‘broadest available definition’” and that Section 524(g) expands on that definition even further to cover “demands” as well.⁶ The Third Circuit concluded that a Section 524(g) injunction can enjoin “any right to or demand for payment that arises from the debtor’s underlying asbestos liabilities, regardless of when that right or demand arises, whether it was raised during the bankruptcy proceeding or is contingent on a future event.”⁷ The court emphasized that under applicable Third Circuit law, a bankruptcy claim can exist “before a right to payment exists under state law.”⁸ Thus, the relevant question is whether W.R. Grace & Co.’s asbestos-related activities formed the initial basis for any right to contribution or indemnity that Montana or the Crown could assert. Because any action that Montana or the Crown may have against W.R. Grace & Co. arises from the same events — the asbestos-related activities — just as all other claims or demands captured by the channeling injunction, the claims of Montana and the Crown for contribution and indemnity are likewise subject to the channeling injunction under the Plan.

Montana and the Crown also asserted that their claims were substantively different from W.R. Grace & Co.’s personal injury, wrongful death or

property-damage actions and therefore cannot be channeled into the trusts.⁹ After affirming that the claims of Montana and the Crown were subject to the injunction under Section 524(g), which expressly enjoins collection of both direct and indirect claims, the Third Circuit concluded that the classification of their claims with the balance of the asbestos personal injury claims under the Plan was reasonable and met the requirements of Section 1122(a), because the legal attributes of the claims were “substantially similar” to other claims in the class.

The Third Circuit also concluded that the Plan did not provide disparate treatment for claims within the same class. Section 1123(a)(4) mandates that each claim in a class must receive the same treatment under a plan, and Section 524(g) requires that present claims and future demands for similar claims be compensated in substantially the same manner.¹⁰ Consistent with other courts to address the issue, the Third Circuit held that Section 1123(1)(4) requires approximate, not precise, equality among claimants. Consequently, differences in the distributions and other procedural variations that did not impact a claimant’s substantive opportunity to recover under the Plan did not violate Section 1123(a)(4).¹¹ “Although there may, at the margins, be some differences in recovery for direct and indirect claims, those differences do not amount to disparate treatment of creditors.”¹²

Finally, Montana and the Crown argued that the Plan violates the “fair and equitable” requirements. Specifically, they alleged that the claim determination procedure lacked certainty regarding the amount and procedure for distribution and that certain members of the Trust Advisory Committee included attorneys for asbestos claimholders, which Montana and the Crown feared might favor direct claimants at the expense of indirect claimants. The Third Circuit rejected this argument, concluding that the channeling injunction was fair and equitable under Section 524(g). The Third Circuit noted that the claims determination process, by its very nature, has a measure of uncertainty that cannot be avoided and that there had been no evidence to suggest that the members of the Trust Advisory Committee had engaged, or would engage, in any impermissible conduct.

CONCLUSION

The Third Circuit’s decision in *W.R. Grace* underscores the expansive definition of “claim” under the Bankruptcy Code and the expansive possible nature of a Section 524(g) injunction. The court rejected the narrow interpretation of Section 524(g) advanced by Montana and the Crown, observing that the debtor’s recovery and the congressional purpose of providing an “evergreen” source of funding to pay future claims would be undercut if the reorganized debtor could still be exposed to indirect asbestos claims for indemnification and contribution.

NOTES

¹ Subject to certain requirements, under Section 524(g), an injunction may be issued preventing entities from taking legal action to pursue recovery of any direct or indirect claim that, under a plan of reorganization, is to be paid from a trust established to assume the liabilities for damages caused by the exposure to asbestos or products containing asbestos. *See* 11 U.S.C. §524(g).

² *In re W.R. Grace & Co.*, No. 12-1521, 2013 WL 4734030 (3d Cir. Sept. 4, 2013) (“W.R. Grace”).

³ The debtor, W.R. Grace, included 62 separate entities; all these entities are collectively referred to as W.R. Grace & Co. herein.

⁴ 11 U.S.C. §1101, *et seq.*

⁵ The personal injury trust and the property damage trust were separately funded and had distinct mechanisms for resolving claims. After a claim against the personal injury trust was reviewed and allowed, the claimant received a percentage of the allowed amount to ensure that there were assets in the trust sufficient to provide comparable payment on future claims; however, after a claim against the property damage trust was allowed, “traditional” property damage claims would be paid in full (traditional property damages claims did not include claims arising from the W.R. Grace & Co. product Zonolite Attic Insulation).

⁶ *In re W.R. Grace & Co.*, No. 12-1521, 2013 WL 4734030, *321 (3d Cir. Sept. 4, 2013) (quoting *FCC v. NextWave Pers. Commc’ns., Inc.*, 537 U.S. 293, 302 (2003)).

⁷ *Id.*, 2013 WL 4734030 at *321.

⁸ *Id.*, 2013 WL 4734030 at *322 (quoting *Wright v. Owens Corning*, 679 F.3d

101, 107 (3d Cir. 2012)).

⁹ See 11 U.S.C. §524(g)(2)(B)(i), explaining that the purpose of the trust “is to assume liabilities of a debtor which...has been named as a defendant in personal injury, wrongful death, or property-damages actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products.”

¹⁰ See 11 U.S.C. §§1123(a)(4) and 524(g).

¹¹ *In re Quigley Co., Inc.* 377 B.R. 110, 116 (Bankr. S.D.N.Y. 2007); see also *In re Multiut Corp.*, 449 B.R. 323, 334 (Bankr. N.D. Ill. 2011).

¹² *In re W.R. Grace & Co.*, No. 12-1521, 2013 WL 4734030, *330 (3d Cir. Sept. 4, 2013).