

Client Alert

Current Issues Relevant to Our Clients

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Can Bankruptcy Sales Be Free and Clear of Unknown Future Claims?

One of the well-known benefits of bankruptcy is that assets can be sold free and clear of claims and interest in the property. But unknown future claims have presented difficulties for purchasers of assets in bankruptcy sales and courts have struggled to devise a clear rule for dealing with such claims. A Delaware Bankruptcy Court recently issued a decision addressing this subject in the context of asbestos claims in the chapter 11 proceeding of Energy Future Holdings Corp.¹ The court surveyed the evolving case law regarding discharge of unknown future claims and concluded that based on the weight of developing authority, publication notice may be sufficient to satisfy due process requirements and allow for the discharge of future unknown claims.

As is typical in bankruptcy cases, the debtors in *Energy Future* brought a motion to establish a bar date by which all parties holding pre-petition claims against the debtors had to file proofs of claim or lose their right to assert such claims. The debtors sought to apply this bar date broadly to all potential claim holders, including those who were exposed to asbestos at one of the debtors' facilities, but had not yet manifested any signs of illness from the exposure. Because holders of such unmanifested claims were unknown to the debtors, and may not have even known they had claims due to the long latency period of asbestos injuries, the debtors proposed to provide notice of the bar date to these potential claimants through publication of notices in newspapers.

A group of asbestos personal injury law firms objected to the bar date motion, arguing among other things, that because asbestos-related injuries can take up to 50 years after exposure to be diagnosed, publication notice would not satisfy the requirements of due process for an "entire class of claimants that are so unknown as to be unknown even to themselves."²

The Bankruptcy Court initially found that because the personal injury law firms did not represent any holders of unmanifested claims, and had no legally protected interest independent of the fact that some of the holders of unmanifested claims could be their future clients, the law firms did not have standing to object to the debtors' bar date motion.³

The Bankruptcy Court nonetheless went on to consider the merits of the objections raised by the personal injury law firms given the due process concerns that were at issue. As a preliminary matter, the Bankruptcy

Court noted that in the Third Circuit (which includes Delaware), a claim arises when a person is exposed pre-petition to a product or conduct that gives rise to an injury, even if the injury manifests after the reorganization. Here, holders of unmanifested claims were exposed to asbestos prior to the commencement of the debtors' bankruptcy cases and, accordingly, such claims were pre-petition claims.

The Bankruptcy Court then surveyed existing case law regarding discharge of unknown future claims and concluded that based on the weight of developing authority, "publication notice *may* be sufficient to satisfy due process and, thus, would allow for discharge of the [u]nmanifested [c]laims."⁴ Although the Bankruptcy Court was sympathetic to all asbestos victims, it noted that the debtors' annual pay-out on behalf of asbestos claims was less than 0.05% of the debtors' consolidated annual revenues, and stated that the bankruptcy case could not be "run for the potential victims' convenience or strategic gains."⁵ On the issue at hand, the Bankruptcy Court ruled that a bar date must be set for all claims, including unmanifested claims.⁶ As long as the debtors publish notice of the bar date in appropriate publications, the debtors have satisfied the requirements of due process and provided the proper notice to cut-off the rights of parties that fail to file a claim by the bar date.⁷

Although purchase agreements in bankruptcy asset sales typically provide that the purchaser is not assuming any tort or other unknown liabilities of the debtor, the potential exists for successor liability with respect to future claimants who had no manifested injury at the time of the bankruptcy. The *Energy Future* decision is an important addition to the debate

regarding successor liability and provides more clarity with respect to discharging claims of unknown future claimants who may have had pre-petition exposure to a debtor's product.⁸

- 1 *In re Energy Future Holdings Corp.*, Case No. 14-10979, Dkt. No. 3183 (Bankr. D. Del. Jan. 7, 2015).
- 2 *Id.* at 6 (emphasis in original).
- 3 Any appeal by the personal injury law firms presents a procedural hurdle because they would first be required to overcome the Bankruptcy Court's finding that they had no standing to object to the bar date motion, before the appellate court would likely consider the merits of their arguments.
- 4 *Id.* at 27 (emphasis in original).
- 5 *Id.* at 29.
- 6 The personal injury law firms had also argued that the only way for the Bankruptcy Court to handle unmanifested claims was through the formation of an asbestos personal injury trust and the issuance of a channeling injunction pursuant to section 524(g) of the Bankruptcy Code. The Bankruptcy Court ruled that due process did not require a channeling injunction or the establishment of a trust; rather, based on the plain meaning of the Bankruptcy Code, what was required was the establishment of a bar date for all claims. Nevertheless, the Bankruptcy Court stated that it would consider proposals under section 524(g) of the Bankruptcy Code if and when they are presented to the Court at the appropriate time.
- 7 The publication, however, must be made in "appropriate" publications. See *White v. Jacobs (In re New Century TRS Holdings, Inc.)*, Case No. 13-1719, 2014 WL 4100749, at *6 (D. Del. Aug. 19, 2014) (noting that the USA Today "enjoys a broad circulation among less sophisticated, focused readers").
- 8 Purchasers, however, should be cautious with respect to environmental liabilities in bankruptcy proceedings because such liabilities can be an important exception to the general rule that an asset purchaser does not acquire the debtor's liabilities. For example, a purchaser who acquires contaminated real estate can itself become liable for the contamination as the "owner" or "operator" of the property post-bankruptcy pursuant to the Comprehensive Environmental Response, Compensation and Liability Act.

For More Information

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