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Bankruptcy Courts Lack Jurisdiction to Enjoin Independent Tort Claims against Nondebtors

Future Claimants Not Bound Absent Adequate Representation

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Marking perhaps the final chapter of a six-year appellate saga that reached the Supreme Court, on March 22, 2010, the Second Circuit ruled for the second time in *Travelers Cas. and Sur. Co. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*.[1] In a precedential, *per curiam* opinion, the court reaffirmed the central ruling of its earlier 2008 opinion[2] that a bankruptcy court's *in rem* jurisdiction over property of the estate does not permit it to bar claims against a nondebtor that are not derivative of the debtor's own tort liabilities. Moreover, the court confirmed that a potential future claimant against a nondebtor, here Chubb Indemnity Insurance Company (Chubb), cannot be constitutionally bound to a bankruptcy court's order that purports to bar non-derivative claims against a nondebtor where its interests were not virtually represented by a future claimants' representative (FCR).


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To understand the court's decision—the *fifth* to issue in this matter—it is necessary to understand its origins in the 1980s. Johns-Manville Corporation (Manville) filed for bankruptcy protection in 1982 in the face of an overwhelming number of asbestos claims while simultaneously embroiled in protracted insurance coverage litigation with its insurers, including its long-time primary liability insurer, Travelers Indemnity Company (Travelers). In 1984, Manville and Travelers announced that they had settled Manville's insurance coverage claims and the bankruptcy court directed notice to be given, including a publication notice, of the proposed settlement. In December 1986, the bankruptcy court issued two orders (the "1986 orders").

The first order granted final approval of the 1984 Travelers' settlement and purported to enjoin all persons from suing Travelers for "policy claims," which were defined as "any and all claims...that have been, or could have been, or might be asserted by any Person against [Travelers] based upon, arising out of or relating to the Policies" issued by Travelers. The second order confirmed the Manville plan, which channeled asbestos claimants with policy claims to the settlement proceeds that were then deposited in the Manville Trust. The 1986 orders were affirmed by the Second Circuit in 1988.[3]


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In 2001, asbestos claimants started suing Travelers and other insurers in so-called "direct action" lawsuits, alleging that they were liable for wrongdoing independent of any tortious conduct by Manville. In 2002, Travelers asked the Manville bankruptcy court to enjoin these actions as prohibited "policy claims" under the 1986 orders because, Travelers alleged, nearly all of its knowledge of the hazards of asbestos came from its insurance relationship with Manville. The court issued a temporary restraining order and directed the parties to mediate, appointing former New York Gov. Mario Cuomo to serve as the mediator. In 2004, the mediation resulted in a series of settlements pursuant to which Travelers agreed to pay nearly $500 million to the claimants and their counsel, conditioned on the bankruptcy court entering a "clarifying" order declaring that the direct actions against Travelers, and any related claims for indemnity or contribution, were in fact barred by the 1986 orders.

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Feature

1 600 F.3d 135 (2d Cir. 2010).
2 *Travelers Cas. and Sur. Co. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52 (2d Cir. 2008).
3 *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89 (2d Cir. 1988).

Chubb, a co-defendant in the direct actions but never a Manville insurer, interposed a limited objection to the proposed 2004 settlement challenging the bankruptcy court's ability to prevent Chubb from asserting potential indemnity and/or contribution claims against Travelers in the direct actions. Chubb raised or joined two arguments that were the subject of later appellate review. First, Chubb asserted that the bankruptcy court lacked subject-matter jurisdiction to enjoin nonderivative claims against Travelers. Second, Chubb contended that it could not constitutionally be bound to the 1986 orders because it was then a potential future claimant who could not be given adequate notice and that the Manville FCR, who was appointed to represent future personal-injury claimants against Manville, did not represent Chubb's interests in those proceedings. The bankruptcy court overruled the objections of Chubb and other objectors, approved the settlements and entered the "clarifying" order declaring that all of the direct actions were barred as against Travelers by the 1986 orders.[4] The district court largely affirmed the bankruptcy court's ruling.[5]

In 2008, the Second Circuit vacated the bankruptcy court's order. In the eyes of the Second Circuit, the bankruptcy court's "clarification" actually improperly expanded the scope of the 1986 injunctions to include claims that were beyond the bankruptcy court's power to bar. In this context, "a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the *res* of the bankruptcy estate;" here, the insurance policies and resulting proceeds from the insurance settlement.[6] The court concluded that insofar as the direct actions rested on alleged independent state-law duties and did not seek to hold Travelers liable for Manville's conduct or recover against the proceeds of the insurance policies or settlement, the bankruptcy court erred in extending the injunction to reach them. Accordingly, the Second Circuit ruled that "[a]lthough the bankruptcy court had jurisdiction and authority to enter the 1986 orders barring claims 'based upon, arising out of, or related to the Policies,' it erred by subsequently interpreting those terms without reference to the court's jurisdictional limits"[7] and that "while there is no doubt that the bankruptcy court had jurisdiction to clarify its prior orders, that clarification cannot be used as a predicate to enjoin claims over which it had no jurisdiction."[8] The Second Circuit noted, but did not address, Chubb's independent due-process argument.[9]

The Supreme Court granted *certiorari*, and reversed the Second Circuit by a 7-2 majority in an opinion captioned *Travelers Indem. Co. v. Bailey*.[10] Ruling on "narrow" grounds, the Court disagreed with the Second Circuit's conclusion that the 2004 "clarifying order" impermissibly expanded the scope of the 1986 orders. Instead, the Court found that, whether or not permissible, the definition of "policy claims" in the 1986 insurance settlement order in fact unambiguously barred even nonderivative claims against Travelers. The Supreme Court therefore concluded that the Second Circuit had impermissibly countenanced a collateral attack on a final order in violation of principles of *res judicata*: "We hold that the terms of the injunction bar the actions and that the finality of the Bankruptcy Court's orders following the conclusion of direct review generally stands in the way of challenging the enforceability of the injunction."[11] The Court also noted Chubb's due-process argument and directed the Second Circuit to consider it on remand.[12]

Following remand, the Second Circuit finally tackled Chubb's argument that it "was not given constitutionally sufficient notice of the 1986 Orders, so that due process absolves it from following them, whatever their scope" and declared, "[i]n our view, Chubb is correct."[13] Applying "bedrock concepts of due process of law,"[14] the court opined that "both the bankruptcy court and the district court erred in rejecting Chubb's due-process argument"[15] and "conclude[d] that Chubb was not afforded constitutionally sufficient notice of the proceedings that led to the entry of the 1986 orders by the bankruptcy court. As such, Chubb is not bound by the bankruptcy court's 2004 interpretation of those orders"[16] as "it would be inconsistent with fundamental notions of due process to bind Chubb to the 1986 Orders."[17]

Significantly, the court emphasized that because the 1986 orders, as interpreted, were not limited to the bankruptcy court's *in rem* jurisdiction over estate property, but also purported to act *in personam* to bar Chubb's independent contribution/indemnity claims against Travelers, "the better due process analogy in terms of notice and representation principles is to class action settlements, not *in rem* bankruptcy proceedings."[18] Applying this analysis, the court had little difficulty concluding that (1) actual notice to Chubb was impossible because the direct actions admittedly were "unimaginable"[19] back in the 1980s and (2) Chubb was not otherwise represented in the proceedings because the FCR only represented future asbestos personal injury claimants against Manville—"Chubb does not fall within that category, and its interests relating to inchoate, nonderivative, post-petition claims against Travelers were not spoken for in those proceedings"—and the interests of the existing claimants in 1986 were not aligned with Chubb's.[20]

Having found that Chubb is not bound by the 1986 orders, the court continued, Chubb was free to attack the bankruptcy court's subject-matter jurisdiction in 2004 in issuing those orders and its attempt to bind Chubb to those ultra-jurisdictional orders. The court then reaffirmed the central holding of its prior decision that the 1986 orders, as interpreted by the bankruptcy court in 2004, exceeded that court's subject-matter jurisdiction to the extent that it purported to enjoin nonderivative claims—direct actions—against nondebtor Travelers arising from Travelers' own independent, allegedly tortious, conduct. Therefore, the court concluded, Chubb is not bound by the 1986 or 2004 orders.

This decision takes on heightened importance because the special trust-injunction provisions of 11 U.S.C. § 524(g) for reorganizing companies facing overwhelming asbestos liabilities were patterned after the

4 *In re Johns-Manville Corp.*, 2004 WL 1876046 (Bankr. S.D.N.Y. Aug. 17, 2004).
5 *In re Johns-Manville Corp.*, 340 B.R. 49 (S.D.N.Y. 2006).
6 517 F.3d at 66.
7 *Id.* at 66.
8 *Id.* at 60-61.
9 *Id.* at 60, n. 17 (observing that "[t]he fact that Chubb's contribution and indemnity rights are even at issue is indicative of the non-derivative liability that these claims allege.").
10 129 S.Ct. 2195 (2009).
11 *Id.* at 2198.
12 *Id.* at 2207.
13 600 F.3d 135, 137.
14 *Id.* at 138.
15 *Id.* at 148-49.
16 *Id.* at 138.
17 *Id.* at 147.
18 *Id.* at 154.
19 *Id.* at 151.
20 *Id.* at 156.

proceedings in the *Johns-Manville* case, including the 1986 orders under review in this appeal. Section 524(g) uniquely authorizes courts to appoint FCRs to represent future asbestos claimants, to channel present and future asbestos claims to trusts, and to enjoin pursuit of such claims against the reorganized debtors. Section 524(g) also permits courts to channel to § 524(g) trusts asbestos claims against certain nondebtors, including insurers, arising from the debtors' tortious conduct in return for these nondebtors' contributions to the trusts. This decision is strong confirmation of the Third Circuit's 2004 ruling in *In re Combustion Eng'g Inc.,* 391 F.3d 190, 225 (3d Cir. 2004), that nondebtors cannot use § 524(g) to cleanse themselves of liability for asbestos claims arising from their own independent conduct.

Further, the opinion should stand as a warning to those who would attempt to encourage a bankruptcy court to undertake to bar nonderivative claims against nondebtors. Even if a bankruptcy court undertakes to do so, and even if its order becomes an unappealable final order, it remains vulnerable to collateral attack by strangers to the proceedings, such as Chubb, who received neither adequate notice nor adequate representation. Moreover, where a bankruptcy court attempts to reach out beyond its *in rem* jurisdiction, adequacy of notice and of representation will be measured, not by presumably more lenient standards of *in rem* notice, but by the more stringent *in personam* standards such as those imposed in the class-action setting. ■

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