BANKRUPTCY BRIEFS

Newsletter of the Bankruptcy Section of the Federal Bar Association

Marc Taubenfeld, Editor *Summer 2014*

LETTER FROM THE CO-CHAIRS

We hope that you enjoy the latest edition of *Bankruptcy Briefs*, the annual newsletter of the Bankruptcy Section of the Federal Bar Association. Once again, the editor of *Bankruptcy Briefs,* Executive Committee member Marc Taubenfeld, and all of the contributing authors have done an excellent job. We trust that you will find something of value inside. Please join us in thanking Marc and all of the contributing authors for their fine work and devotion to the section and its members.

This has been another exciting year for the Bankruptcy Section. Among other things, the Bankruptcy Section has continued to support legal scholarship, continuing legal education, and networking opportunities. Members of the Bankruptcy Section have published and circulated regular updates on significant cases through our ongoing "Circuit Writer" project. We cannot thank enough those who have written the updates and worked tirelessly to ensure that these updates reach all of you in a timely manner. Those members are listed on the website at http://www.fedbar.org/Sections/Bankruptcy-Law-Section/Weekly-Circuit-Updates.aspx. Special thanks as well to Executive Committee members the Honorable Craig A. Gargotta (Bankr. W.D. Tex.) and Christopher Sullivan for shepherding this effort. If you are interested in contributing to this important project, please contact with Judge Gargotta or Chris and let them know.

In addition, members of the Bankruptcy Section again have contributed articles and judicial profiles to *The Federal Lawyer*, the official magazine of the Federal Bar Association. We are gearing up for another bankruptcy-focused edition in 2015, and ask Section members interested in contributing to reach out to either of us or any of the members of the Executive Committee.

The Bankruptcy Section continues its proud tradition of sponsoring (or co-sponsoring with other sections and chapters of the Federal Bar Association and with other bankruptcy organizations, including the National Conference of Bankruptcy Judges and the American Bankruptcy Institute) bankruptcy themed continuing legal education programs throughout the country. In the past year, the Bankruptcy Section has provided financial support for a number of events, including continuing legal education, moot court competitions, and social gatherings, and our members have presented at continuing legal education seminars.

"The Executive Committee intends to make a concerted effort to increase the communication with among members of the section, including through additional use of social media."

We are pleased to report that once again, members of our Section, including past Section Chair Judge Alan Trust (Bankr. E.D.N.Y.) and Executive Committee member the Honorable Craig A. Gargotta (Bankr. W.D. Tex.), will be featured presenters at the FBA Annual Meeting in Providence, Rhode Island

(Continued on page 2)

LETTER FROM THE CO-CHAIRS (CONTINUED)

in September. Details of the Annual Meeting are available at http://www.fedbar.org/Education/Calendar-CLE-events/2014-Annual-Meeting-and-Convention.aspx. Don't miss this important presentation!

In addition, the Bankruptcy Section will conduct its own Annual Meeting during the FBA Annual Meeting. We will get together in person on Friday, September 5, 2014 beginning at 3:30 p.m. (Eastern) in the Washington Room, Omni Providence Hotel, 1 West Exchange Street, Providence, RI. Members may also attend by phone (Dial in: 888-804-1335; Conference Room Number: 2347920). On the agenda will be election of Bankruptcy Section officers for the upcoming year. In that regard, the Executive Committee has nominated the following members to serve as officers for the upcoming year:

Nominee	Nominated Position	Prior Position
Mark L. Desgrosseilliers	Chair	Co-Chair, Board member
Lisa L. Lambert	Chair-elect	Treasurer, Board member
Hon. Craig A. Gargotta	Treasurer	Board member
Christopher D. Sullivan	Secretary	Board member

For those members attending in person (and for others attending the Federal Bar Association Annual Meeting), the Bankruptcy Section will host a cocktail reception immediately following the Bankruptcy Section's Annual Meeting, from 4:30 to 6:00 p.m. (Eastern) in the South County Room at the Omni Providence Hotel. We and other members of the Executive Committee look forward to meeting you and discussing the Bankruptcy Section and how we can work together to make the Bankruptcy Section better serve your needs.

During the next year, the Bankruptcy Section will continue to support continuing legal education, scholarship, and opportunities for members of the bankruptcy community to get to know each other a little better. The Executive Committee intends to make a concerted effort to increase the communication with among members of the section, including through additional use of social media. We need the active engagement of our members to continue to have an effective and responsive Bankruptcy Section and build on the strong foundation laid by the efforts of those members, officers, and Executive Committee members who have come before us.

In closing, we thank you for the opportunity to serve the Bankruptcy Section and thank the other officers and the members of the Executive Committee for their hard work and dedication throughout the past year. As always, we welcome your comments and suggestions. If you are interested in serving the Bankruptcy Section in any manner, whether by contributing content to the Bankruptcy Section's publication, joining one the Bankruptcy Section's committees, or coordinating continuing legal education and social events in your community, please contact either of us or any other members of the Executive Committee.

Regards,

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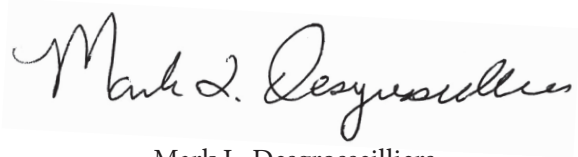

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TAKE TWO:

SUPREME COURT TO RECONSIDER FAMILIAR ISSUES IN *IN RE SHARIF*

OVERVIEW:

In the upcoming term, the Supreme Court may answer vital issues left undetermined by the unanimous opinion in *In re Bellingham Insurance Agency, Inc.* The Court will consider the case of Wellness International Network, Ltd. v. Sharif (*In re Sharif*), reviewing the Seventh Circuit's dual holdings that (1) a litigant may not waive an Article III objection to a bankruptcy court's constitutional authority to enter final judgment in a core proceeding, and (2) the bankruptcy court lacked constitutional authority under Article III to enter final judgment on Wellness International Network's state-law alter-ego claim. 727 F.3d 751, 775 (7th Cir. 2013), *cert granted*, 13-935, 2014 WL 497634 (U.S. July 1, 2014).

THE FACTS:

BACKGROUND ON EXISTING LAW

Prior to discussing *In re Sharif*, a brief overview of the Court's somewhat indeterminate holding in *In re Bellingham Insurance Agency* is helpful. In that case, Bellingham Insurance Agency, Inc. (BIA), filed a voluntary Chapter 7 bankruptcy petition. *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2169 (2014). The bankruptcy trustee filed a complaint in the bankruptcy court against petitioner Executive Benefits Insurance Agency (EBIA) alleging the fraudulent conveyance of assets from BIA to EBIA. *Id.* The bankruptcy court granted summary judgment for the trustee. *Id.* EBIA appealed to the district court, which affirmed the bankruptcy court's decision after *de novo* review and entered judgment for the trustee. *Id.* While an appeal to the Ninth Circuit by EBIA was pending, the Court held that Article III did not permit a bankruptcy court to enter final judgment on a counterclaim for tortious interference, even though final adjudication of that claim by the bankruptcy court was authorized by statute. *Stern v. Marshall*, 564 U.S. ––––, ––––, 131 S.Ct. 2594, ––––, 180 L.Ed.2d 475. Given the ruling in *Stern*, EBIA moved to dismiss its appeal for lack of jurisdiction. Executive Benefits Ins. Agency, at 2169. The Ninth Circuit rejected EBIA's motion and affirmed. *Id.* It acknowledged the trustee's claims as "*Stern* claims," i.e., claims designated for final adjudication in the

bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter. *Id.* The Ninth Circuit concluded that EBIA had impliedly consented to jurisdiction, and that the bankruptcy court's judgment could instead be treated as proposed findings of fact and conclusions of law, subject to *de novo* review by the district court. *Id.* at 2170.

The notable take away from the Supreme Court's holding in *In re Bellingham* is that the severability provision of the Bankruptcy Amendments and Federal Judgeship Act of 1984 allows *Stern* claims to proceed as "non-core" rather than "core" within the meaning of 28 U.S.C § 157(c) as long as they are "related to a case under title 11." *Id.* at 2173. However, what may be of more importance is the Court's decision not to rule definitively that fraudulent conveyances are in fact *Stern* claims or that parties can consent to a bankruptcy court's jurisdiction over *Stern* claims. *Id.* at 2174 ("The Court assumes without deciding that these [fraudulent conveyance] claims are *Stern* claims, which Article III does not permit to be treated as "core" claims under § 157(b)"); *Id.* at 2174 ("[T]he District Court's *de novo* review of the bankruptcy court's order and entry of its own valid final judgment cured any potential error…. EBIA contends that it was constitutionally entitled to review by an Article III court regardless of whether the parties consented…. In the alternative, EBIA asserts that even if such consent were constitutionally permissible, it did not in fact consent. Neither contention need be addressed here, because EBIA received the same review from the district court that it would have received had the bankruptcy court treated the claims as non-core proceedings under § 157(c)(1)."). *Id.* at 2175. The Court has seemingly decided to take another shot at answering these two questions by granting *cert* in the largely analogous case of *In re Sharif*.

Justice Thomas's opinion states that:

"…if a matter is 'non-core' and the parties have not consented to final adjudication by the bankruptcy court, however, the bankruptcy judge must propose findings of fact and conclusions of law, and the district court must review the proceeding de novo and enter final judgment."

Executive Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 2172 (2014) (emphasis added).

THE PROCEEDINGS BELOW

In 2003, Richard Sharif and others sued Wellness International Network (WIN) claiming that WIN was running a pyramid scheme. *Wellness Int'l Network, Ltd. v. Sharif*, 727 F.3d 751, 755 (7th Cir. 2013), *cert granted*, 13-935, 2014 WL 497634 (U.S. July 1, 2014). The case was ultimately refiled in the Northern District of Texas after being dismissed without prejudice by the Northern District of Illinois upon remand by the Seventh Circuit. *Id.* The plaintiffs ignored WIN's discovery requests which resulted in the material facts being admitted against them. *Id.* The district court granted summary against the plaintiffs for WIN, and the Fifth Circuit affirmed. *Id.* at 755-56. Upon remand, the district court awarded WIN $655,596.13 in attorney's fees. Sharif later filed a bankruptcy petition under Chapter 7 in the Northern District of Illinois, listing WIN as a creditor. *Id.* After WIN filed a proof of claim, it obtained a past loan application Sharif had submitted on which he claimed to be the trustee of a trust with a total value of more than $5 million. *Id.* 756-57. WIN and the bankruptcy trustee requested that Sharif produce documents evidencing the formation and funding of the trust, but Sharif failed to do so. *Id.* WIN subsequently initiated an adversary proceeding in the bankruptcy court alleging five counts: four which sought to prevent discharge of Sharif's debts under 11 U.S.C. § 727, and sought a declaratory judgment that the trust was Sharif's alter ego and should be treated as part of the bankruptcy estate. *Id.* During the proceeding, Sharif yet again failed to comply with a court order compelling discovery. *Id.* at 757-58. Thereafter, Sharif moved for summary judgment to which the bankruptcy court issued an opinion and order entering default judgment for WIN on all five counts of the adversary complaint. *Id.* at 758.

Sharif appealed the bankruptcy court's decision to the district court. Sharif argued that his right to due process under the Fifth Amendment had been violated because he was allegedly never given notice by WIN of his particular discovery deficiencies, and that the bankruptcy court abused its discretion in entering a default judgment because Sharif had been a trustee not a beneficiary of the trust. *Id.* 759-60. Sharif later added an additional claim of error alleging that the bankruptcy court lacked jurisdiction to enter a final judgment under *Stern*. *Id.* at 760. The district court concluded that Sharif had standing as to the *Stern* issue, but that objections based on the bankruptcy court's authority to enter a final judgment are waivable because they do not implicate subject matter-jurisdiction and Sharif failed to raise the issue sooner. *Id.* The district court applied a deferential standard of appellate review on the merits in considering whether the bankruptcy court's entry of sanctions constituted an abuse of discretion and whether its factual findings were

clearly erroneous. *Id.* Upon review, the district court affirmed, and Sharif appealed the decision to the Seventh Circuit. *Id.*

THE CIRCUIT ARGUMENT AND RULING

On appeal, Sharif reargued his position that the bankruptcy lacked constitutional authority to enter a final judgment on WIN's alter-ego claim under the holdings of *Stern* and *In re Ortiz*, 665 F.3d 906 (7th Cir. 2011) (holding that a bankruptcy court lacked constitutional authority to enter final judgment on debtors' claims that were grounded in Wisconsin law). *Id.* at 760-61. WIN countered this contention by arguing that Sharif waived his lack of authority argument by failing to object sooner in the litigation, and thereby consented to final adjudication by the bankruptcy judge. *Id.* at 761. Sharif contrarily averred that a *Stern* objection is not waivable and may be raised at any time because it concerns subject-matter jurisdiction. *Id.* at 767.

The Seventh Circuit first took up the issue of waiver, concluding that parties cannot consent to final adjudication of a core proceeding by a bankruptcy judge or waive a *Stern* objection. *Id.* at 772. However, the court of appeals found both parties' arguments on the issue unpersuasive. Although the Seventh Circuit acknowledged that "under 28 U.S.C. § 157(c)(2) parties may consent to final resolution of a noncore proceeding by a bankruptcy judge," they disagreed that such a notion extends to core proceedings. *Id.* The Seventh Circuit reasoned that Congress purposefully "left the essential attributes of judicial power to Article III courts" with respect to noncore proceedings, and that "the structural interests at issue with regard to core proceedings are not present under the current statutory scheme applicable to noncore proceedings, thereby allowing room for notions of waiver and consent." *Id.* The Seventh Circuit further pointed out that the Supreme Court had held in *Stern* "that the statutory scheme granting bankruptcy judges authority to enter final judgment in core proceedings does implicate structural concerns where the core proceeding at issue is the stuff of the traditional actions at common law…." *Id.* at 771 (internal citations and quotations omitted). As a result, the Seventh Circuit held that a litigant cannot waive an Article III, § 1, objection to a bankruptcy court's entry of final judgment in a core proceeding. *Id.* at 773.

The court of appeals next turned to Sharif's constitutional objection to the bankruptcy court's authority over WIN's alter-ego claim. Sharif argued that bankruptcy court lacked constitutional authority to enter final judgment on WIN's alter-ego claim but conceded that the bankruptcy court had such authority on all other counts brought under 11 U.S.C. § 727. The Seventh Circuit agreed on both points. *Id.* at 773. As to Sharif's concession, the Seventh Circuit reasoned that those claims stemmed from federal law, and as such, the Supreme Court has not come close to holding "that an Article III judge must decide claims for which the Bankruptcy Code itself provides the rule of decision, and [the Seventh Circuit] [would] not do so…where the parties concede that the bankruptcy judge had authority." *Id.* Accordingly, the court of appeals held that under the current law, the bankruptcy court possessed authority to enter final judgment on the discharge claim brought under 11 U.S.C. § 727. *Id.*

The Seventh Circuit likewise agreed with Sharif's argument that the bankruptcy court lacked constitutional authority. First, WIN's alter-ego was asserted against the trust, which was a nonparty to the bankruptcy proceedings. *Id.* at 775. Second, the Seventh Circuit opined that despite some overlap with the objections to discharge under 11 U.S.C. § 727, "nothing indicat[ed] that it ha[d] any relation to the claims-allowance process." *Id.; citing Stern v. Marshall*, 131 S.Ct. 2594, 2618, 180 L.Ed.2d 475 (2011) ("Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.") Third, the alter-ego claim was "in no way derived from or dependent upon bankruptcy law; it is a state [claim] that exists without regard to any bankruptcy proceeding." *Id.* Finally, the court of appeals explained that it could not "say that in resolving WIN's claims under 11 U.S.C. § 727 the bankruptcy court *necessarily* would have resolved the alter-ego claim had it reached the merits (as opposed to entering default judgment)." *Id.* (emphasis in original). The Seventh Circuit accordingly decided that the bankruptcy court lacked authority to enter a final judgment on the declaratory judgment cause of action because "WIN's alter-ego claim is a state-law claim between private parties that is wholly independent of federal bankruptcy law and is not resolved in the claims-allowance process." *Id.*

POTENTIAL IMPACT

In re Sharif has the potential to drastically affect the bankruptcy courts' ability to enter final judgments on state-law claims that have traditionally fallen under their purview. The justices might issue a more precise ruling on what actually qualifies as a *Stern*

claim, and thereby exactly which core proceedings should continue on as non-core as delineated by *In re Bellingham*. The district courts may no doubt fear that an inclusive definition of *Stern* claims would further crowd their dockets by increasing the amount of required *de novo* reviews. However, *In re Bellingham*, which was decided after the Seventh Circuit rendered its opinion in *In re Sharif*, appears to hint at the Court's position on waiver/consent of non-core proceedings. Justice Thomas's opinion states that "if a matter is "non-core" and *the parties have not consented to final adjudication by the bankruptcy court*, however, the bankruptcy judge must propose findings of fact and conclusions of law, and the district court must review the proceeding *de novo* and enter final judgment." *Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2172 (2014) (emphasis added). The Court seems to be implying, albeit not deciding, that parties may indeed consent to final adjudication by the bankruptcy court of non-core claims. Moreover, the ability of parties to consent to final adjudication of non-core proceedings by the bankruptcy court comports with 28 U.S.C. § 157(c)(2).

If the Court issues a determinative opinion, it would help mend the split that has developed among the circuits on the issues of constitutional authority and consent. In *Waldman v. Stone*, the Sixth Circuit held that a party could waive an objection to a bankruptcy court's statutory authority but could not waive a constitutional objection. 698 F.3d 910, 917-18 (6th Cir. 2012). To the contrary, in *In re Bellingham Insurance Agency*, the Ninth Circuit found that a party could waive its right to have an Article III judge decide a matter. *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 566-70 (9th Cir. 2012) *cert. granted,* 133 S. Ct. 2880, 186 L.Ed.2d 908 (2013) and *aff'd sub nom. Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165 (2014). The Fifth Circuit has tackled the same issues in *Frazin v. Haynes & Boone, L.L.P.* (*In Re Frazin*, 732 F.3d 313, 319 (5th Cir. 2013)) and in *In re BP RE, L.P.* (735 F.3d 279 (5th Cir. 2013)). The court held in *In re Frazin* that the bankruptcy court lacked constitutional authority to enter final judgment on certain state-law counterclaims by the debtor, even though the debtor had impliedly consented to the bankruptcy court's jurisdiction. *Frazin*, 732 F.3d at 319. In I*n re BP RE*, the court found that where a bankruptcy court lacked the constitutional authority to enter final judgment on a party's non-core state-law claims, a party cannot cure the constitutional deficiency by consenting to having its claims heard in bankruptcy court. *In re BP*, 735 F.3d at 279. After the *In re BP RE* decision, nearly half of the Fifth Circuit judges voted in favor of a petition for rehearing *en banc* on the issue of whether a bankruptcy court, consistent with its statutory authority under 28 U.S.C. § 157(c)(2), may enter final judgment in a non-core proceeding with the parties' consent. 744 F.3d 1371 (the six pro-rehearing judges were out-voted by their other eight colleagues).

Because *In re Sharif* has the potential to drastically change the judicial landscape as we know it today, attorneys and courts alike should pay close attention this fall when the Supreme Court decides whether or not it will do so. ■

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FEDERAL BAR ASSOCIATION / FBA BANKRUPTCY SECTION

UPCOMING EVENTS

September 4-6, 2014

FBA Annual Meeting and Convention in Providence, RI

September 5, 2014

(A) 8:45 a.m. — 9:45 a.m.:

Bankruptcy Section presents Top Ten Bankruptcy Cases of the Past Year at the FBA Annual Meeting

Panelists:

- Hon. Craig Gargotta, U.S. Bankruptcy Judge, Western District of Texas
- Hon. Frank Bailey, U.S. Bankruptcy Judge; District of Massachusetts, Eastern Division
- Hon. Alan S. Trust, U.S. Bankruptcy Judge, Eastern District of New York

(B) 3:30 p.m. — 4:30 p.m.

at Washington Room, Omni Providence Hotel

Bankruptcy Section Annual Meeting to Elect New Officers, at the FBA Annual Meeting

(C) 4:30 p.m. — 6:00 p.m. at South County Room, Omni Providence Hotel

Reception for Bankruptcy Judges and Practitioners, at the FBA Annual Meeting

October 6, 2014

Federal Contracts in Bankruptcy CLE and Reception (joint presentation with ABI and Government Contracts Section of FBA) – Alexandria, VA

October 24, 2014, 1:00 p.m. - 6:00 p.m.

Strategies and Litigation Tactics in the Bankruptcy Court (presentation of the Puerto Rico Chapter of the Federal Bar Association): Inter American School of Law, Hato Rey, P.R.

October 30-31, 2014

Iowa Federal Bar Association's 33rd Annual Bankruptcy Conference – Des Moines, Iowa

November 14, 2014

Noon: Bankruptcy Section joint presentation with FBA Dallas Chapter at Belo Mansion, Dallas

November 21, 2014

Bankruptcy Ethics Symposium (joint presentation of the Bankruptcy Section and the FBA Los Angeles Chapter); Los Angeles

March 28, 2015

2015 Mid-year meeting: Westin Arlington Gateway; Arlington, VA

September 10-12, 2015

FBA Annual Meeting and Convention in Salt Lake City, Utah

BANKRUPTING ASBESTOS CLAIMS IN THE 5TH CIRCUIT

ISSUE:

The underlying legal issue in this case is whether a bankruptcy court may, consistent with the Constitution's guarantee of due process, hold that a state-law wrongful-death claim based on the death of a housewife, who fatally contracted mesothelioma from asbestos fibers on her husband's work clothes, was discharged in a bankruptcy filed by her husband's former employer fifteen years before she developed or was aware of any symptom of the disease." *Jimmy Williams, Sr. et. al. v. Placid Oil Co. (In re Placid Oil Co.)*, 753 F.3d 151, 159 (5th Cir. 2014)(Dennis, J., dissenting).

FACTUAL BACKGROUND

In 2004 Appellants Jimmy Williams Sr. (Mr. Williams) and his children (collectively, the Williams/Williamses) brought suit in state court under Louisiana's wrongful death and survival statutes on behalf of their deceased wife/mother, Mrs. Myra Williams (Mrs. Williams). Mrs. Williams died of mesothelioma as a result of asbestos exposure in 2003. Appellee, Placid Oil Company (Placid) was a named co-defendant in the Louisiana state case due to Mr. Williams's employment at its refinery from 1966 to 1988.

THE BANKRUPTCY PROCEEDING:

By 1986, market forces had caused Placid to file for chapter 11 bankruptcy in order to prevent foreclosure. On November 19, 1986 the court entered an Order Setting Bar Date setting January 31, 1987 as the bar date for potential creditors to file claims. In addition to the requisite notice provided to scheduled creditors, Notice of the Bar Date was timely published in the *Wall Street Journal* three times in January 1987. Placid confirmed its Fourth Amended Plan of Reorganization in 1988. The Order confirming the Debtor's Plan provided, in relevant part, that all claims against Placid that arose on or before September 30, 1988 were forever discharged except for the Reorganized Debtor's obligations under the Plan. The Order also prohibited claimants from pursuing the Reorganized Debtor to enforce any claims that fell within the scope of the Discharge.

In response to the state suit, Placid filed a Motion to Reopen Chapter 11 Proceedings in 2008 to determine that certain pre-petition claims were discharged and to enforce the discharge injunction. Placid's motion was granted by the bankruptcy court on January 22, 2009 for the limited purpose of determining whether certain claims being asserted against Placid, including those articulated in the State Court Petition, came within the scope of the Discharge and Discharge Injunction.

For purposes of the proceeding, both parties agreed that Mr. Williams was exposed to asbestos while employed at the refinery, and that Mrs. Williams was exposed to asbestos as a result of laundering her husband's clothes. Placid also conceded that the asbestos-laden products which caused Mrs. Williams's exposure were in the care, custody, control of Placid through 1988. Additionally, to Mr. Williams's knowledge, none of his co-workers at the refinery, nor any of their spouses, had ever developed an asbestos-related illness.

THE ISSUES RAISED IN BANKRUPTCY COURT:

After the reopening, two distinct issues were raised in the bankruptcy proceeding; whether Mr. and Mrs. Williams had pre-existing claims at the time of confirmation; and to what degree the Williams' claims, if existing at the time of confirmation, were subject to Due Process notice requirements. The bankruptcy court ruled that the Williams' claims existed pre-confirmation and were discharged due to Placid's timely constructive notice in the *Wall Street Journal*. Because the claims were found to exist pre-confirmation, Mrs. Williams was an "unknown" creditor in relation to Placid at the time constructive notice of the bar date was published. The

bankruptcy court also found that the constructive notice was sufficient so as to notify the Appellants.

ON APPEAL:

On appeal, Appellants only contested the sufficiency of notice issue, not appealing the issue of the claims' existence before confirmation. The Fifth Circuit affirmed the bankruptcy court's decision 2-1. Both the majority and the dissent agreed that the level of notice required was premised on a determination of whether the Appellants were "known" or "unknown" creditors in 1988 – in other words, whether the asbestos-caused death of Mrs. Williams was "reasonably ascertainable" (and therefore "known") by Placid at the time of confirmation.

> In light of these cases and Crystal Oil, the majority stated, ***"thus to conclude that a creditor is known, a court must determine that, at a minimum, a debtor has 'specific information' related to an actual injury suffered by the creditor. Information, however specific, that makes a claim only foreseeable or conjectural is insufficient."*** In re Placid Oil, 753 F.3d at 156 (citing Crystal Oil, 158 F.3d at 297).

Whether the Williamses were "known" or "unknown" creditors at the time of discharge

According to the majority's affirmation, the crux of the dispute rested in the interpretation of *In re Crystal Oil*, 158 F.3d 291 (5th Cir. 1998), in which the Fifth Circuit held; "In order for a claim to be reasonably ascertainable, the debtor must have in his possession, at the very least, some specific information that reasonably suggests both the claim for which the debtor may be liable and the entity to whom he would be liable. By contrast, the debtor need only provide 'unknown creditors' with constructive notice by publication." *Crystal Oil* at 297. The majority used the Placid Oil case to clarify *Crystal Oil*, holding; "At one extreme, the law does not require that a creditor serve upon the debtor a formal complaint in order to make himself 'reasonably ascertainable' or 'known.' However, at a minimum, the debtor must possess 'specific information' about a manifested injury, to make the claim more than merely foreseeable." *In re Placid Oil Co.*, 753 F.3d 151, 155 (5th Cir. 2014).

In support of their interpretation of *Crystal Oil*, the majority cited similar interpretations of *Crystal Oil* in the First Circuit, see *In re Arch Wireless, Inc.*, 534 F.3d 76 (1st Cir. 2008) (emails from creditor to debtor prior to the bankruptcy alleging debtor's faulty products causing substantial losses could reasonably be understood to assert an entitlement to affirmative compensation), and in the Fourth Circuit, *see In re J.A. Jones, Inc.*, 492 F.3d 242 (4th Cir. 2007)(an employee of the debtor was fully aware of a highly publicized accident therefore the victim's estate was a known creditor even though no pre-petition claims had been filed).

In light of these cases and *Crystal Oil*, the majority stated, "thus to conclude that a creditor is known, a court must determine that, at a minimum, a debtor has 'specific information' related to an actual injury suffered by the creditor. Information, however specific, that makes a claim only foreseeable or conjectural is insufficient." *In re Placid Oil*, 753 F.3d at 156 (citing *Crystal Oil*, 158 F.3d at 297). The majority determined that Placid had no duty to send actual notice the Williams' because Placid lacked any specific knowledge as to the Williams' claims at the time of bankruptcy – also rejecting the notion that the Williams' were "known" creditors (to Placid) simply because of Placid's knowledge of the risks arising from asbestos exposure. *In re Placid Oil*, 753 F.3d at 157. The majority states that even if the Williams' were "known" creditors by way of mere exposure, a mandate requiring Placid (and similar debtors) to send actual notice to every current and former employee would impose an undue burden. *Id.* Instead, Mr. and Mrs. Williams' Due Process notice rights as "unknown creditors" were satisfied by the Williams' general knowledge of the risks of asbestos exposure, coupled with the constructive notice of the bar date in the *Wall Street Journal*. Id at 158. Because the Williams' failed to bring their claims in a timely manner, the Fifth Circuit held that recovery on Mrs. Williams's subsequent death caused by the asbestos exposure was discharged by the bankruptcy.

At oral argument, the majority rejected the Williams' interpretation of the Third Circuit case *Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.)*, 607 F.3d 114, 127 (3rd Cir. 2010), holding:

The Williamses asserted that under *Grossman's*, sufficiency of notice hinges on whether claimants were aware of their vulnerability to asbestos or on a "reasonableness" standard. Regarding the first test, awareness of vulnerability was only one of many factors that the court in dicta recommended that the lower court consider in its discharge analysis. Another factor was "whether the claimants were known or unknown creditors." In any case, Mr. Williams was aware of his vulnerability: He knew that he was exposed to asbestos in his work, and the dangers of asbestos were widely known at the time, as even the Williamses contend. As for "reasonableness" of notice, the Third Circuit articulated no such amorphous standard; rather, the overall test is whether the notice comported with due process.

In re Placid Oil, 753 F.3d 151, 155, footnote 2 (5th Cir. 2014)

The majority noted the careful policy considerations surrounding a case like *In re Placid Oil*, namely, the balancing act a court must maintain- between the interests of the "struggling debtor" in receiving a clean start, against the interests of facilitating mass-tort creditors' rights to recovery and due process. *Id.* at 157.

THE DISSENT

The Fifth Circuit panel's decision in *In re Placid* was not unanimous, resulting in a dissenting opinion issued along with the circuit court's majority opinion. The essence of the dissent emanates from a different interpretation of an "unknown future claim".

"Unknown, future claim" refers to the future claim of an asbestos-exposed individual whose disease has not manifested itself by the time of the bankruptcy filing. In other words, it is a claim that is unknown to either the debtor or the potential creditor at that time."

Id. at 159, footnote 1 (Dennis, J., dissenting)

Whereas the majority defined an "unknown future claim" through the eyes of a debtor, the dissent considered the term in the eyes of both parties. At the time of notice, the harm from the asbestos exposure is conjectural to both the debtor and the creditor. Therefore, an unknown creditor, whose claim is unknown to him at the time of bankruptcy, cannot be reasonably expected to be put on notice via constructive notice. The dissent cited the Supreme Court case *Amchem Products, Inc. v. Windsor* (521 U.S. 597, 602-03 (1997)) in support of the fundamentally unknown nature of asbestos-related claims. *In re Placid Oil Co.*, 753 F.3d 160-61 (Dennis, J., dissenting).

The dissent recognizes the conundrum which asbestos claims cause in the context of bankruptcy and calls for, as a remedy, the appointment of a future claims representative (FCR).

> ***"This narrow interpretation alone could potentially have a significant effect given the expansive scope of asbestos use in America within the past 5 generations."***

When an individual cannot recognize that he or she has a claim in a bankruptcy case and, therefore, cannot make a decision about how to assert that claim, that person is functionally or constructively 'incompetent' for purpose of the bankruptcy case. These claimants have no ability to represent their own interests in the bankruptcy case because they cannot be given the information necessary to enable them to make decisions about those interests. Consequently, constructive notice cannot reach them because they do not know of their claims. In other words, publication is not notice at all. However, a bankruptcy court may appropriately appoint a guardian *ad litem*—or, stated differently, a future-claims representative—to represent their interests in an adversary proceeding under Bankruptcy Rule 7017.

Id. at 162(Dennis, J., dissenting) (*citing* B. Bartell, Due Process for the Unknown Future Claim in Bankruptcy – Is This Notice Really Necessary? 78 AM.BANKR.L.J. 339, 366 (2004).

In conclusion, the dissent holds:

"Neither *Lemelle* nor *Mullane*…should be read as holding that due process has been satisfied when all that is provided is constructive notice to exposure-only individuals who may be unaware of their exposure, unaware of the severe harm that may ultimately result, and unable to recognize that their rights may be affected in bankruptcy. Rather, careful thought and a context-specific approach is required before concluding that unknown, future claimants have been provided with notice and

an opportunity to be heard such that their claims may, consistent with the guarantee of due process, be discharged."

Id. at 164 (Dennis, J., dissenting).

POSSIBLE IMPACT

*Note: all subsequent statements are made under the assumption that the defendant/debtor is the proximate cause of the plaintiff/creditor's potential claim.

This is a narrow holding that does not significantly affect Due Process notice requirements. However, even narrowly applied, the holding may still effectively absolve all immature asbestos-related claims against bankrupt debtors who caused the injured party's exposure. The court sided with the debtors by only subjecting manifested asbestos-related claims to the scrutiny of Due Process. By requiring actual notice to only those for whom the debtor has "specific knowledge," the burden is put on the creditor to provide evidence of a manifested injury upon receipt of constructive notice.

This narrow interpretation alone could potentially have a significant effect given the expansive scope of asbestos use in America within the past 5 generations. (*See* National Institute for Occupational Safety and Health, Center for Disease Control and Prevention, Morbidity and Mortality Weekly Report. Vol. 58 (15), 393-396, (2009). The sheer number of asbestos-related claims in the Fifth Circuit (and the United States in general) makes any decision on the topic significant. This decision, insofar it precludes claims manifested after plan confirmation, may affect thousands of unknown creditors and millions of dollars in recovery.

There is, however, a potential limitation to the majority's holding. As addressed by the dissent, the appointment of a future claims representative could solve the dilemma *In re Placid Oil* sheds light on. If read in a very fact-specific manner, this holding might only apply to those claims which were caused by asbestos-exposure before the passage of 11 U.S.C. 524 (g)-(h) in 1994. By passing this amendment, Congress granted a court the power to appoint a future claims representative. Because Placid's bankruptcy plan was confirmed in 1988, the court was without the statutory authority to appoint such a future claims representative. Therefore, if distinguished on its facts, *In re Placid Oil* might only be applicable to immature asbestos claims discharged in bankruptcy cases filed before 1994, and asbestos claims discharged in cases filed after 1994, without the appointment of a future claims representative, might be in violation of Due Process requirements, as expounded by the dissent. ■

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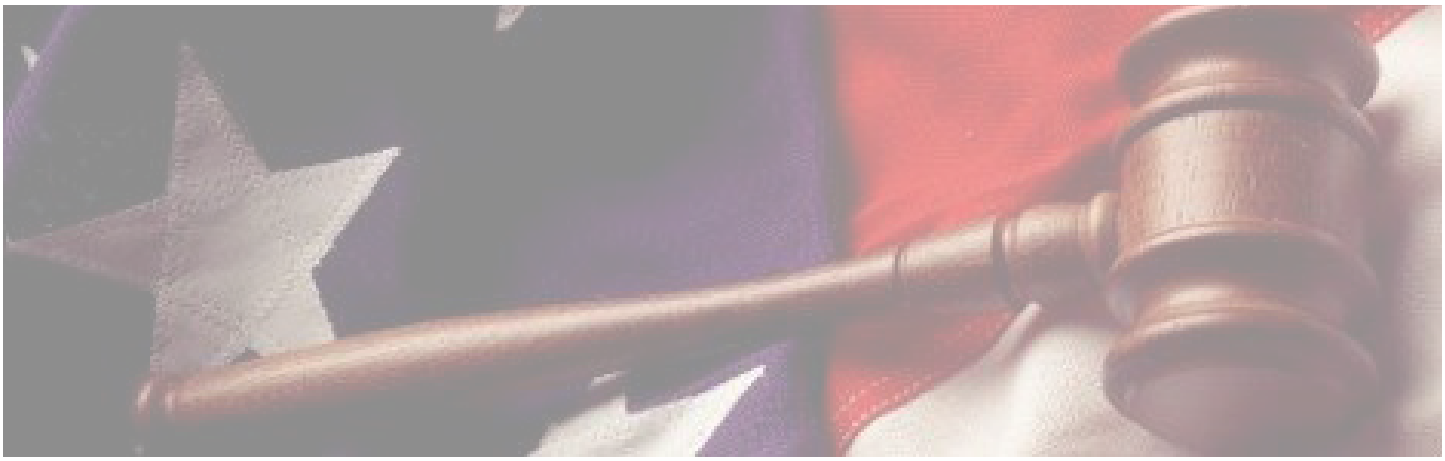

Fifth Circuit Upholds Fee Enhancement But Strikes Down Defense Costs in *In re ASARCO L.L.C.*

The Fifth Circuit recently issued its long-awaited opinion in *ASARCO, L.L.C. v. Jordan Hyden Womble Culbreth & Holzer, P.C. (In re ASARCO, L.L.C.)*, 751 F.3d 291 (2014), addressing two issues of particular interest to any professional seeking compensation from a bankruptcy estate. First, the panel reaffirmed well-established Fifth Circuit precedent allowing fee enhancements in "rare and extraordinary" cases. Second, the panel addressed whether an estate professional can recover the costs and expenses incurred while defending its fee application (for convenience, "defense costs"). Writing for a unanimous panel, Judge Edith Jones affirmed the district and bankruptcy courts' awards of fee enhancements but reversed the award of defense costs.

The dollar amounts of the compensation awarded to Baker Botts by the bankruptcy court and affirmed by the district court are staggering—core fees of $113 million, a fee enhancement of $4.1 million, and defense costs of $5 million. But, after the Fifth Circuit's opinion, the math is simple: Baker Botts had to spend more money defending its core fee award than it received in a fee enhancement.

I. BACKGROUND

For brevity, a summary-level overview of the complicated factual and procedural background in *ASARCO* is all that a short article will afford. ASARCO is an integrated copper mining, smelting, and refining company. Declining copper prices, labor issues, and environmental liabilities forced ASARCO into chapter 11 in 2005. The debtor in possession employed Baker Botts LLP as lead counsel and Jordan Hyden Womble Culbreth & Holzer, P.C. ("Jordan Hyden") as local counsel.

The centerpiece of the eventual 100-cent plan was Baker Botts's successful fraudulent transfer suit against ASARCO's parent company, Grupo Mexico, S.A.B. de C.V. ("Grupo"). Two years before the bankruptcy filing, Grupo had orchestrated a leveraged-buyout to obtain ASARCO's controlling interest in a Peruvian copper mine. Baker Botts proved Grupo had acted with actual fraudulent intent as to the transfer, and the estate obtained a judgment valued between $7 and $10 billion—the largest unreversed fraudulent transfer judgment in U.S. history. In exchange for release of the judgment, Grupo funded ASARCO's plan, which paid creditor's claims in full (including interest and attorneys' fees) and left the reorganized debtor

free of its environmental liabilities and $1.4 billion in cash (the "Reorganized ASARCO").

Baker Botts filed its final fee application pursuant to 11 U.S.C. § 330, seeking approval of its core fees and requesting a twenty-percent fee enhancement. Although the debtor's board of directors endorsed such an enhancement before exiting bankruptcy, the Reorganized ASARCO—once again controlled by Grupo—was less agreeable, challenging "the fees on a large scale."

Fast-forwarding through one round of appeal to, and remand by, the district court, the bankruptcy court certified a direct appeal to the Fifth Circuit. Thus, Baker Botts arrived at the Fifth Circuit with endorsements by the bankruptcy and district courts of (1) a $113 million core fee award; (2) a $4.1 million fee enhancement; and (3) a $5 million award for defense costs.

II. DISCUSSION

A. 11 U.S.C. § 330 AND DEFINING "REASONABLE" COMPENSATION

Section 330 of the Bankruptcy Code (the "Code") governs compensation for professional persons employed by the estate. After notice and a hearing, a court may award "reasonable compensation for actual [and] necessary services rendered . . . and reimbursement for actual, necessary expenses." 11 U.S.C. § 330(a)(1)(A)-(B). The statute includes a non-exhaustive example list of factors to consider when determining whether compensation is actual, necessary, and reasonable, which include:

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

While fee enhancements are safe, for now, defense costs are decidedly not. The Fifth Circuit created a split of authority at the courts of appeals level by adopting the minority view on compensation of defense costs.

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

Id. § 330(a)(3)(A)-(F). Subject to the general rule in subsection (a)(1), time spent preparing a fee application is also compensable. *Id.* § 330(a)(6).

The court may, sua sponte or on the motion of any party in interest, reduce the compensation requested by the amount not qualifying as actual, necessary, and reasonable. *Id.* § 330(a)(2). Moreover, the statute explicitly provides that compensation shall not be awarded for duplicative services or "services that were not—(I) reasonably likely to benefit the debtor's estate; or (II) necessary to the administration of the case." *Id.* § 330(a)(4)(A).

In addition to section 330—or, more accurately, since long before section 330 — bankruptcy courts in the Fifth Circuit have relied on the lodestar method and the *Johnson/First Colonial* factors to gauge actual, necessary, and reasonable. *CRG Partners Grp., L.L.C. v. Neary (In re Pilgrim's Pride Corp.)*, 690 F.3d 650, 654-55 (5th Cir. 2012) (discussing Johnson v. Ga. Highway Express, Inc., 488 F.2d 714 (5th Cir. 1974), and *Am. Benefit Life Ins. Co. v. Baddock (In re First Colonial Corp. of Am.)*, 544 F.2d 1291 (5th Cir.), cert. denied, 431 U.S. 904 (1977)). The lodestar rate comes from multiplying a reasonable number of hours by a reasonable fee. The *Johnson/First Colonial* factors are twelve alternative guideposts to determine whether fees are reasonable, many of which Congress has incorporated into § 330(a)(3). A hybrid approach used by most courts calculates the lodestar fee, makes adjustments as necessary according to the *Johnson/First Colonial* factors, and then applies § 330(a) to the result. The combined process can

be an onerous, duplicative, and circuitous exercise to arrive at a number deemed to be "reasonable."

B. FEE ENHANCEMENTS

The Reorganized ASARCO argued that the Supreme Court's decision in the civil rights case of *Perdue v. Kenny A. ex rel. Winn*, 559 U.S. 542, 550 (2010), prohibits fee enhancements subject to three inapplicable exceptions. But the Fifth Circuit held that it had resolved that issue a year earlier in *CRG Partners*, finding that the panel therein "stated explicitly that *Perdue* did not overrule [the Fifth Circuit's] bankruptcy precedent authorizing fee enhancements under other, albeit limited circumstances pursuant to Section 330(a)." *ASARCO*, 751 F.3d at 296 (citing *CRG Partners,* 690 F.3d at 660-67). As a result, the Circuit's ruling on the first issue presented in *ASARCO* was predictable.

Fee enhancements for estate professionals employed under § 327—at least in the Fifth Circuit—remain firmly established for the "rare and exceptional" result, which usually means a full recovery for creditors. The panel in ASARCO thoroughly discussed and dismissed the Reorganized ASARCO's arguments that the result was anything but "rare and extraordinary."

C. DEFENSE COSTS

While fee enhancements are safe, for now, defense costs are decidedly not. The Fifth Circuit created a split of authority at the courts of appeals level by adopting the minority view on compensation of defense costs. That minority view applies the so-called "American Rule" under which each party bears its own costs without a "specific and explicit" statutory exception. *Bentley v. Fanguy*, 396 F. App'x 130, 131 (5th Cir. 2010) (citing *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 260 (1975)). Generally, the courts adopting the minority view argue that a professional's services *defending* a fee application—as compared to *preparing* a fee application—benefit only the applicant, not the estate. Such fees and expenses, these courts reason, are a necessary "cost of doing business." *ASARCO*, 751 F.3d at 301.

In comparison, the Ninth Circuit, and the vast majority of lower courts, allow recovery of defense costs for successful defenses. This view arose from a pair of Ninth Circuit cases. *See Smith v. Edwards & Hale, Ltd. (In re Smith)*, 317 F.3d 918 (9th Cir. 2002), *abrogated on other grounds by Lamie v. U.S. Tr.*, 540 U.S. 526, 531-39 (2004); *Boldt v. Crake (In re Riverside-Linden Invs. Co.)*, 945 F.2d 320 (9th Cir. 1991). These courts typically hold the time spent defending a fee application benefits the estate because it sets the amount of an administrative expense. *See* 11 U.S.C. § 503(b)(4) (affording administrative expense priority to certain estate professionals).

The opinion in *ASARCO* relies heavily on the deterrent

provided by the Federal Rules of Bankruptcy Procedure —that is, presumably, the disclosure requirements under Rule 2016 and the bankruptcy courts power to sanction under Rule 9011 and disgorge fees under Rule 2017(a) and 11 U.S.C. § 329. Specifically, Judge Jones stated:

Compliance with the rules should ordinarily reduce the need for or likelihood of success of satellite litigation over fees . . . . The perverse incentives that could arise from paying the bankruptcy professionals to engage in satellite fee litigation are easy to conceive.

ASARCO, 751 F.3d at 300-01. Likewise, "thoroughly documenting fee applications," in the panel's view, should be sufficient to deter challenge. *ASARCO*, 751 F. 3d at 301, footnote 7.

While sanctions are certainly an appropriate remedy for meritless fee objections, the panel's reasoning appears to overlook the reality that rules may be bent before being broken. Indeed, as Baker Botts argues in its petition for a writ of certiorari in *ASARCO*,

[L]awyers can be savvy enough to avoid sanctions while nonetheless imposing unreasonable burdens that dilute core fees. While "sanctions provide some protection against harassment, a fee objection is a gambit easily veiled in a policy of economy."

Petition for Writ of Certiorari, *supra* note 9, at 36 (quoting Springer, *supra* 1, at 539 n.101).

III. CONCLUSION

Baker Botts may have an opportunity to plead its case with the Supreme Court, having filed its petition for a writ of certiorari on July 29, 2014. That the Fifth Circuit created a potential three-way circuit split between the Ninth and Eleventh Circuit certainly favors further review. Nonetheless, for now, § 327 professionals are left without a safety net to backstop their efforts in "rare and extraordinary" cases. As a result, "the policy fears behind the 1994 Amendment of unequal pay may be realized, and rare and exceptional cases may be even more rare and exceptional indeed." Springer, *supra* note 1, at 558. ■

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Footnotes

1 For a more-thorough discussion of ASARCO and the issues involved, see Timothy S. Springer, *Damned If You Do, Damned If Your Don't—Current Issues for Professionals Seeking Compensation in Bankruptcy Cases Under 11 U.S.C. § 330*, 87 AM. BANKR. L.J. 529 (2013).

2 The bankruptcy court also awarded Jordan Hyden a fee enhancement and defense costs. For convenience, references to Baker Botts include Jordan Hyden where relevant. As will be discussed, the reorganized debtor's quarrel was principally with Baker Botts and only minimally with Jorden Hyden.

3 Based on a historic reversal of copper prices following the transfer, the value of the equity interest rose from approximately $850 million to over $3 billion. Springer, *supra* note 1, at 550 n.186.

4 As Fifth Circuit practitioners know, this statutory language was the basis for the decision in *Andrews & Kurth L.L.P. v. Family Snacks, Inc. (In re Pro-Snax Distributors, Inc.)*, 157 F.3d 414 (5th Cir. 1998). There, the Fifth Circuit held, to be compensable by the estate, services must result in an "identifiable, tangible, and material benefit to the bankruptcy estate." *Id*. at 426. Many courts have applied *Pro-Snax* as statutory language, effectively engrafting an additional requirement onto the § 330 analysis. But that analysis may change soon. Recently, a three-judge panel applied *Pro-Snax* and then together joined in a special concurrence advocating for an en banc reconsideration of its decision and the decision in P*ro-Snax. Barron & Newburger, P.C. v. Tex. Skyline Ltd. (In re Woerner)*, --- F.3d ----, No. 13-50075, 2014 WL 3443653, at *8-10 (5th Cir. July 15, 2014) (Prado, J., concurring).

5 For a detailed discussion of the genesis of "actual, necessary, and reasonable" from the Bankruptcy Act to the Code, see Springer, *supra* note 1, at 529-35.

6 Please, fellow practitioners, take note of the correct citations above for *Johnson* and *In re First Colonial*. Both cases are staples in fee applications under § 330 and yet are almost universally cited incorrectly.

7 *See* Springer, *supra* note 1, at 545-46 (discussing and distinguishing the statutory and policy bases in *Perdue* from § 330).

8 Interestingly, while the "rare and extraordinary" burden is on the applicant under § 327, Fifth Circuit precedent involving enhancements for professionals employed under § 328 puts the burden on the challenger. *See, e.g., Daniels v. Barron (In re Daniels)*, 325 F.3d 690, 693-94 (5th Cir. 2003); *Peele v. Cunningham (In re Tex. Sec., Inc.)*, 218 F.3d 443, 446 (5th Cir. 2000). Under § 328, to the extent that retention is based on a compensation scheme other than a lodestar-type calculation, the compensation is fixed unless the employment's "terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." 11 U.S.C. § 328(a). As a result, unless a challenger can prove an enhancement under was incapable of being anticipated at the time of retention, Fifth Circuit precedent affords an applicant employed under § 328 the benefit of his or her bargain, even if it causes a windfall. *See Daniels*, 325 F.3d at 694 (upholding a compensation arrangement for a § 328 professional despite the resulting amount more than doubling the lodestar fee).

9 "At least thirty-six cases from twenty-nine courts in ten different circuits have acknowledged bankruptcy courts' discretion to award compensation for successful fee defenses." Petition for Writ of Certiorari at 21 n.6, app. G, Baker Botts L.L.P. v. ASARCO LLC (2014) (No. 14-103), 2014 WL 3735731.

10 Hereinafter, "Rule" or "Rules," as appropriate.