SUCCESSOR LIABILITY IN BANKRUPTCY ASSET SALES

ADEQUATE NOTICE -- THE FIRST STEP IN CUTTING OFF SUCCESSOR LIABILITY CLAIMS

John G. Loughnane
Goodwin, Procter & Hoar LLP
Exchange Place
Boston, MA 02109

American Bankruptcy Institute
Committee on Asset Sales
Winter Leadership Conference
December, 1996

INTRODUCTION

Many parties to a bankruptcy proceeding share the common goal of maximizing the assets of the estate. Frequently, the most effective manner of maximizing assets is through a sale of estate property. Potential buyers of assets, however, are not concerned with maximizing the estate's assets. To the contrary, potential buyers are content to pay only the amount necessary to acquire the assets.

In any sale context, a critical issue affecting the amount of the purchase price is the amount of any liabilities of the seller the buyer will assume. The general rule, in and outside bankruptcy, is that an asset acquiror does not assume any liabilities of the seller. Four traditional exceptions to this rule exist: (1) where the purchaser agrees, expressly or impliedly, to assume the obligations of the seller; (2) where the purchaser is deemed to constitute a mere continuation of the seller; (3) when the transaction is entered into fraudulently to escape liability; and (4) when the transaction amounts to a consolidation or de facto merger. A fifth exception, known as the product line exception, also has been recognized by courts in some states when a purchaser acquires a manufacturing business and continues the output of its line of products.[1]

If the purchase of assets falls within one of these exceptions, the purchaser may be liable as successor of the seller for a broad range of liabilities under state and federal law including liability for unpaid pension contributions, environmental torts, violations of the Fair Labor Standards Act, misrepresentations, fraud, RICO, federal and state usury laws, violations of federal lending laws and products liability.

Because the scope of the successor liability risk affects a buyer's purchase price decision, parties to a bankruptcy proceeding have an interest in (i) understanding the risk and (ii) minimizing the risk to allow maximization of the estate's assets. This article attempts to provide assistance on both counts by focusing on the fundamental role of notice in successor liability cases.[2]

Part I below provides a brief overview of asset sales in bankruptcy in general. Part II discusses the fundamental role of notice in cutting off successor liability claims. Part III presents some practical tips that may help minimize the risk of successor liability and, thus, help maximize the assets of a bankruptcy estate.

---

1 See generally Ray v. Alad, 19 Cal. 3d. 22 (1977).

2 The issue of notice is irrelevant when a claimant is not able to satisfy all elements of applicable successor liability law. See Conway v. White Trucks, A Division of White Motor Corp., 885 F.2d 90 (3d Cir. 1989) (upholding district court's interpretation of Pennsylvania successor liability doctrine that successor liability was unavailable where the plaintiff had a remedy against the predecessor -- even as limited a remedy as filing a claim).

I. OVERVIEW OF ASSET SALES IN BANKRUPTCY

The Bankruptcy Code permits sales of assets of the estate in one of three ways. Assets can be sold pursuant to § 363 of the Bankruptcy Code (i) in the ordinary course of business under § 363(c), without notice or a hearing or (ii) other than in the ordinary course of business, under § 363(b), after notice and a hearing. Assets may also be sold in a Chapter 11 reorganization as part of a plan of reorganization under § 1123(a)(5). Sales pursuant to § 363(b) and § 1123(a)(5) are discussed below.

A. Section 363(b) Sales

Section 363(b) of the Bankruptcy Code provides that "the trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate." The notice procedure for sales under § 363(b) is set forth in Bankruptcy Rules 2002, which requires 20 day notice, and 6004, which requires than any objection to a proposed sale be filed within five days before the date set for the proposed action or set by the court. An objection to the proposed sale is a contested matter governed by Bankruptcy Rule 9014. Although § 363(b)(1) speaks in terms of "notice and a hearing," the phrase, as defined by § 102(1), allows the court to authorize the sale of assets without an actual hearing if notice is properly given and no party in interest timely requests a hearing.

Pursuant to Code § 363(f), assets can be sold pursuant to § 363(b) "free and clear" in certain circumstances. In particular, Code § 363(f) provides:

> The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if –
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C.§ 363(f). As the above italicized words make clear, § 363(f) states that property can be sold under § 363 free and clear only of any "interest." Nowhere does the Code explicitly authorize a § 363 sale to be made free of "claims." The terms are not interchangeable.

The term "interest", although not defined in the Code, is generally recognized to include a lien and other encumbrances on property. See Collier on Bankruptcy ¶ 363.07. Some courts have also concluded that the term is broad enough to include unsecured in personam liabilities of the seller. See W.B.Q. Partnership v. Virginia Dep't of Medical Assistance Servs. (In re W.B.Q. Partnership), 189 B.R. 97, 105 (Bankr. E.D. Va. 1995). Other courts, however, have refused to endorse a broad interpretation of § 363's plain language. See Fairchild Aircraft, Inc. v. Campbell (In re Fairchild Aircraft Corp.), 184 B.R. 910, 918 (Bankr. W.D. Tex. 1995) (plain language of statute is not broad enough to extinguish in personam liabilities). See also Michael H. Reed, Successor Liability and Bankruptcy Sales, 51 Bus. Law. 653, 665 n.62 ("There is nothing in the Code, however, to suggest that the term 'interest' was intended to embrace rights to payment, which are substantive nuclei of bankruptcy 'claims'.").

The term "claim" is defined by the Code as any right to payment or any right to an equitable remedy for breach of performance if the breach gives rise to a right to payment, whether contingent, fixed, liquidated, unliquidated, matured or unmatured, disputed or undisputed, reduced to judgment, legal, equitable, secured or unsecured.[3] As a general rule of thumb, a claim arising out of a transaction prior to the commencement of the bankruptcy proceeding is a pre-petition claim; a claim arising from operative facts occurring after the commencement of the bankruptcy proceeding is a post-petition claim.

---

[3] "Claim" is defined in 11 U.S.C. § 101(5) to mean:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5) (emphasis supplied). The intended breadth of this definition is emphasized in the legislative history to 11 U.S.C. § 101(5):

> By this broadest possible definition [of "claim"] and by the use of the term throughout the title 11 . . ., the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 309 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 21 (1978).

Substantial problems exist, however, in reconciling the broad definition of "claim" with the reality that a debtor's prepetition conduct may give rise to unknown, future claims. In particular, claims based on products liability, mass torts and environmental obligations relating to a debtor's prepetition conduct may not all be known at the time of the bankruptcy proceeding. The details of the analysis of future claims is beyond the scope of this article and have been treated elsewhere. See generally Kathryn Heidt, Products Liability, Mass Torts and Environmental Obligations in Bankruptcy: Suggestions for Reform, 3 ABI L. Rev. 117 (1995).

Asset purchasers will be concerned about the risk of successor liability on account of future claims as well as traditional claims. The best course of action for those interested in maximizing the purchase price for an estate's assets is to understand the risks of successor liability and to take cost-effective steps in an effort to minimize such risks. Notice is the constitutional starting point for cutting off claims, and notice issues are discussed in Part II below.

B. Sales under a Chapter 11 Plan

Section 1123(a)(5) of the Bankruptcy Code provides that a plan may be implemented by means of a "sale of all or any part of the property of the estate, either subject to or free of any lien." Section 1141(c) states that "property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor." § 1123(a)(5) (emphasis added). This language is broader than the language in § 363(f) discussed above. Because of the broader statutory language in §1141(c), many commentators have noted that it might be preferable for a buyer to acquire assets under a plan under § 1129 rather than pursuant to a sale under § 363(f).

A reorganized debtor typically receives a discharge upon confirmation of a plan. The statutory authority for discharge is 11 U.S.C. § 1141(d)(1)(A), which provides: "Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan discharges the debtor from any debt that arose before the date of such confirmation . . . ." Discharge of prepetition debts results regardless of whether a proof of claim was filed or deemed filed, whether the claim was allowed, or whether the claimant accepted the plan. The confirmation of a plan does not discharge an individual debtor from certain nondischargeable debts under the Code, nor does it discharge a corporate debtor if the debtor does not engage in business after the consummation of the plan.

The substantial uncertainty that exists concerning the treatment of future claims in bankruptcy proceedings essentially concerns the dischargeability of such claims. See generally Ralph Mabey and Jamie Andra Gavrin, Constitutional Limitations on the Discharge of Future Claims in Bankruptcy, 44 S. Car. L. Rev. 745 (1993). Whether a predecessor's bankruptcy discharge precludes assertion of a claim against a successor depends in part on whether the claimant had a bankruptcy claim that was addressed adequately in the insolvency proceeding. See Ninth Avenue Remedial Group v. Allis-Chalmers Corp., 195 B.R. 716 (N.D. Ind. 1996) ("It appears that while the bankruptcy courts might have the power to sell assets free and clear

of any interest that could be brought against the bankruptcy estate during bankruptcy, either through Section 363(f) or through the powers of the bankruptcy court under other sections of the Code, a sale free and clear does not include future claims that did not arise until after the bankruptcy proceeding is concluded.").

II. NOTICE ISSUES

The goal of maximizing assets in a bankruptcy proceeding does not exist in a vacuum. Thus, although an acquiror who could be assured that no successor liability claims could be or would be asserted against it would presumably pay more for the estate's assets, courts refuse to allow the due process rights of creditors to be trampled to achieve the asset maximization goal. Bankruptcy participants who can establish that creditors' due process rights have been protected should benefit from a higher purchase price in the acquisition setting. The first step in providing due process is notice. This Part discusses recent decisions regarding three central concepts about notice: (i) a purchaser of assets cannot successfully disclaim successor liability without any notice to the court or creditors; (ii) a judicial blessing of a successor liability disclaimer that is made without adequate notice to creditors is attackable; and (iii) adequate notice is the fundamental method of protecting the due process rights of creditors.

A. Disclaimers of Successor Liability Made Without Any Notice to the Court and/or Creditors are Subject to Attack

The risk of successor liability is substantial when notice, sufficient to satisfy due process standards, has not been provided to a debtor's creditors. The First Circuit made that point clear in Western Auto Supply Company v. Savage Arms, Inc. (In re Savage Industries, Inc.), 43 F.3d 714 (1st Cir. 1994). In that case, Savage Industries, Inc. ("Savage"), a firearms manufacturer, filed for Chapter 11 relief in February, 1988 in the United States Bankruptcy Court for the District of Massachusetts. In July, 1989, the Bankruptcy Court approved a sale of substantially all of Savage's assets to Savage Arms, Inc. ("Buyer"), a newly incorporated entity. The sale closed in November 1989 pursuant to the terms of an asset transfer agreement that was negotiated by the parties after the court's July 1989 sale approval order. Under the terms of the sales agreement, Buyer assumed liability for certain pending product liability claims asserted against Savage, but Buyer explicitly disclaimed all liability for any other product liability claim. Immediately after the sale, Savage ceased to operate and, without interruption, Buyer took up the manufacture of identical lines of firearms previously produced by Savage.

Meanwhile, in May 1989, a consumer ("Claimant") was injured by a firearm manufactured by Savage. One year after the closing of the asset transfer sale, Claimant brought a product liability action in Alaska state court against Savage and the retailer who had sold the firearm. The retailer then filed a third-party complaint against Buyer alleging that Buyer was liable under the theory of successor product line liability as recognized by Alaska state law. In June, 1991, the Bankruptcy Court approved Savage's Chapter 11 liquidation plan, which made no provision for contingent product liability claims disclaimed by Buyer.

Buyer then requested declaratory and injunctive relief from the Bankruptcy Court supervising the Debtor's Chapter 11 proceeding, asserting that it had acquired Savage's assets "free and clear" of all product liability claims other than those disclosed to it by Savage.

The Bankruptcy Court enjoined the retailer from further prosecuting the third-party action, reasoning that Claimant's claim arose before the asset sale and Claimant was restricted to a pro rata share of the net proceeds from the asset sale. The Bankruptcy Court held that Buyer's explicit disclaimer in the asset transfer agreement had to be given full effect, at least in the absence of collusion, in order to prevent circumvention of the priority scheme of the Bankruptcy Code and the chilling of asset sales. The District Court concluded that the Bankruptcy Court lacked jurisdiction to enjoin prosecution of the Alaska state court action and vacated the injunction.

The First Circuit affirmed the District Court's order, concluding that the Bankruptcy Court erred when it enjoined the action against Buyer. The First Circuit determined that neither the retailer nor Claimant were afforded appropriate notice of either the Chapter 11 proceeding or the asset sale. The First Circuit believed that the existence of forty-four pending product liability claims at the time of the asset sale strongly suggested that Savage was or should have been on notice that certain types of firearms and thus, distributors, were "prominent candidates for future indemnification claims." Id. at 721. The First Circuit's decision makes clear that a complete failure to provide notice to creditors of a successor liability disclaimer will not pass constitutional muster and will leave a successor entity exposed. Yet, the decision provides no guidance as to the type and manner of notice that should have been provided to the Claimant and retailer. Instead, the Court's decision appears fixated on its conclusion that the Buyer's non-assumption of liability claims based on Savage's pre-petition conduct was a "closet term" in a "privately negotiated" agreement that was never disclosed to the Court or any other party. 43 F.3d at 723. As the First Circuit's decision makes clear, a purported disclaimer of successor liability made without notice to the court or creditors is ineffective.

B. Disclaimers of Successor Liability Approved by the Court are also Subject to Attack in the Absence of Proper Notice to Creditors

Moreover, even disclosure to and court approval of a liability-limiting provision cannot infringe the due process rights of successor liability claimants. The Seventh Circuit made that point clear in a decision relating to the Chapter 11 case of Cary Metal Products, Inc. ("Cary") which, as debtor in possession, sold all of its assets to Zerand-Bernal Group, Inc. ("Zerand"). The sale agreement was subject to entry by the bankruptcy court of an order approving the sale "free and clear of any liens, claims or encumbrances of any sort or nature" and reserving jurisdiction in the bankruptcy court to enjoin "any products liabilities claims arising prior to the Closing or relating to sales made by [Cary] prior to the Closing." Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159, 161 (7th Cir. 1994). Thereafter, Cary and the creditors' committee jointly filed and obtained confirmation of a plan providing for the liquidation of Cary and the establishment of a trust fund to pay out the proceeds from the sale to Zerand. The plan was

then consummated, with all proceeds from the sale being distributed to Cary's creditors. Four and a half years after the sale, Ronald Cox, who had been injured by a machine manufactured and sold by Cary before the sale to Zerand, filed suit against Cary, Zerand and others in federal district court in Pennsylvania. Zerand then filed an adversary complaint in bankruptcy court in Chicago, seeking to reopen the bankruptcy proceeding and asking that Cox be enjoined from proceeding against Zerand in Pennsylvania. The bankruptcy court (which had originally entered the above order) held it lacked jurisdiction, and the district court affirmed.

The Seventh Circuit also affirmed, reasoning that the products liability suit neither arose in nor was related to Cary's bankruptcy case within the meaning of 28 U.S.C. § 1334(b). Specifically, the Seventh Circuit held that the products liability suit against Zerand was neither a claim by or against the debtor; that while all assets had been sold free from all liens and other encumbrances, Cox was not trying to enforce a lien; that even under 11 U.S.C. § 524(d), the discharge operated as injunction only against suing the debtor; and that allowing the bankruptcy court blanket power to enjoin all future lawsuits would allow the parties to bankruptcy sales to extinguish the rights of third parties without notice to them or any consideration of their interests.

In reaching its jurisdictional conclusion, the Court downplayed the "tenuous" federal interest in protecting bankruptcy asset purchasers from successor liability claims:

> Zerand points out that the price received in a bankruptcy sale will be lower if a court is free to disregard a condition in the sale agreement enjoining claims against the purchaser based on the sellers' misconduct. . . . All this is true, but proves too much. It implies, what no one believes, . . . that by virtue of the arising-under jurisdiction a bankruptcy court enjoys a blanket power to enjoin all future lawsuits against a buyer at a bankruptcy sale in order to maximize the sale price: more, that the court could in effect immunize such buyers from all state and federal laws that might reduce the value of the assets bought from the bankrupt; in effect, that it could discharge the debts of nondebtors (like Zerand) as well as of debtors even if the creditors did not consent; that it could allow the parties to bankruptcy sales to extinguish the rights of third parties, here future tort claimants, without notice to them or (as notice might well be infeasible) any consideration of their interests. If the court could do all these nice things the result would indeed by to make the property of bankrupts more valuable than other property. . . . But the result would not only be harm to third parties, such as the Coxes, but also a further incentive to enter

> bankruptcy for reasons that have nothing to do with the purposes of bankruptcy law.

23 F.3d at 163.

The Seventh Circuit has recently gone a step further and suggested that even proper notice to creditors may not necessarily protect against successor liability claims. The Court's suggestion was made in Chicago Truck Drivers, Helpers & Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc., 59 F.3d 48 (7th Cir. 1995), which involved a secured party's foreclosure action -- not an acquisition. In that case, two months after Tasemkin Furniture Company, Inc. ("Old Tasemkin") filed for bankruptcy relief, New Tasemkin, Inc. ("New Tasemkin"), a company owned by the daughter-in-law of the owner of Old Tasemkin, was incorporated and acquired the security interest in Old Tasemkin's assets from Old Tasemkin's secured lender. New Tasemkin then obtained relief from stay, foreclosed on its collateral and obtained Old Tasemkin's assets. The bankruptcy case was then closed. Union pension funds ("Funds") with claims against Old Tasemkin received no dividend. Two years after closure of the bankruptcy case, the Funds filed suit against New Tasemkin on the theory of successor liability. The District Court dismissed the suit.

The Seventh Circuit reversed, noting that successor liability under federal common law allows lawsuits even against "even a genuinely distinct purchaser of a business if (1) the successor had notice of the claim before the acquisition; and (2) there was 'substantial continuity in the operation of the business after the sale.'" 59 F.3d at 49. The Court held that the Funds could pursue a lawsuit under successor liability against New Tasemkin despite the fact that the Funds had participated in the bankruptcy. Although the District Court had held that a suit under successor liability would allow a creditor to circumvent the Bankruptcy Code's priority scheme, the Court of Appeals found that "a second chance is precisely the point of successor liability, and it is not clear why an intervening bankruptcy proceeding, in particular, should have a *per se* preclusive effect on the creditor's chances." Id. at 51.

C. What Type of Notice and Notice to Whom?

The above decisions emphasize that a bankruptcy asset sale does not constitute a magic wand that automatically dispenses with the need for due process. Indeed, the decisions clearly hold that the risk of successor liability claims is minimized when the due process rights of creditors during the bankruptcy proceeding have been protected. A good starting point for understanding due process is the Third Circuit's recent decision in Chemetron Corporation v. Jones, 72 F.3d 341 (3d Cir. 1995), cert. denied, 116 S.Ct. 1424 (1996).

In that case, Chemetron Corporation ("Chemetron"), an owner and operator of a landfill which received radioactive rubble, filed a Chapter 11 petition in 1988. Thereafter, the bankruptcy court fixed a claims bar date and required (1) that actual notice be provided to all persons known to have claims against Chemetron and (2) that constructive notice be provided to all other claimants by publication of notice in the national editions of the New York Times

and Wall Street Journal. In addition to complying with the order, Chemetron voluntarily published notice in several other local newspapers.

Nineteen months after confirmation of the Chemetron plan, various plaintiffs sued Chemetron in state court. Chemetron moved to dismiss arguing that the claims had been discharged in bankruptcy. The claimants then filed a motion in bankruptcy court seeking permission to file late claims. The bankruptcy court found that the claimants (former residents and occasional visitors to the area near the landfill), were known creditors entitled to actual notice of the bankruptcy proceeding and the claims date, and granted the motion to file late claims. The district court reversed.

The Third Circuit affirmed the district court's decision, ruling that the central issue was whether the claimants were known or unknown claimants to Chemetron since that determined the amount of notice to be afforded to the claimants:

> Inadequate notice is a defect which preclude discharge of a claim in a bankruptcy. Due process requires notice that it is "reasonably calculated to reach all interested parties, reasonably conveys all the required information, and permits a reasonable time for a response." For notice purposes, bankruptcy law divides claimants into two types, "known" and "unknown." Known creditors must be provided with actual written notice of a debtor's bankruptcy filing and bar claims date. For unknown claimants, notification by publication will generally suffice.
>
> As characterized by the Supreme Court, a "known" creditor is one whose identity is either known or "reasonably ascertainable by the debtor." Tulsa Professional Collection Serv., Inc. v. Pope, 485 U.S. 478, 490 (1988). An "unknown" creditor is one whose "interests are either conjectural or future or, although they could be discovered upon investigation, do not in due course of business come to knowledge [of debtor]." Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 317 (1950).
>
> A creditor's identity is "reasonably ascertainable" if that creditor can be identified through "reasonably diligent efforts." Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 798 n. 4 (1983). Reasonable diligence does not require "impracticable and extended searches ... in the name of due process." Mullane, 339 U.S. at 317. A debtor does not have a "duty to search out each conceivable or possible creditor and urge that person or entity to make a claim against it." In re Charter Co., 125 B.R. 650, 654 (M.D. Fla. 1991).

> Precedent demonstrates that what is required is not a vast, open-ended investigation. See Mullane, 339 U.S. at 317 ("Nor do we consider it unreasonable for the State to dispense with more certain notice to those beneficiaries whose interests are either conjectural or future or, although they could be discovered upon investigation, do not in due course of business come to knowledge of the common trustee."). The requisite search instead focuses on the debtor's own books and records. Efforts beyond a careful examination of these documents are generally not required. Only those claimants who are identifiable through a diligent search are "reasonably ascertainable" and hence "known" creditors.

72 F.3d at 346-47 (footnote and various citations omitted).

According to the Third Circuit, the Bankruptcy Court improperly used a "reasonably foreseeable" test to determine whether the plaintiffs were known or unknown creditors, in lieu of the proper "reasonably ascertainable" test. According to the Third Circuit, the Bankruptcy Court's reasonably foreseeable test "would place an impossible burden on debtors." 72 F.3d at 347. Because none of the plaintiffs currently lived near the site, the Court found itself "hard-pressed to conceive of any way the debtor could identify, locate and provide actual notice to these claimants." Id. The Court rejected the plaintiffs' contention that Chemetron should have conducted a title search to determine the identities of possible claimants. In sum, the Court concluded that the constructive notice provided to the plaintiffs was constitutionally sufficient.[4]

Judge Sarokin, in a concurring opinion, wrote to state his belief that both the "'reasonably foreseeable' and 'reasonably ascertainable' tests are applicable in determining the identities of "known" creditors. In his view, the "'reasonably foreseeable' test determines which persons are entitled to notice" while "[t]he 'reasonably ascertainable' test determines the type of notice [actual or constructive] these people are entitled to receive." Id. at 351. Applying this reasoning to the Chemetron facts, Judge Sarokin would have determined that, because federal agencies had made numerous assurances over the years that no environmental problems existed at the site, the plaintiffs were not reasonably foreseeable claimants to Chemetron at the time of the bankruptcy filing and, thus, were unknown creditors. Because the claims were not foreseeable, there was no reason to determine whether the claimants were reasonably ascertainable.

---

[4] The Third Circuit's decision was criticized in Kewanee Boiler Corp. v. Smith (In re Kewanee Boiler Corp.), 198 B.R. 519, 538 (Bankr. N.D. Ill. 1996) ("Most of [the plaintiffs] were foreseeable victims who could have been ascertained by a diligent title search and interviews with some residents and, as to persons not specifically identified, noticed through local publications, local distribution of pamphlets, and notices in publications that service injury attorneys."). In light of the Kewanee decision's attack on meaningless notices (see infra), the Kewanee court evidently believed that some of the Chemetron plaintiffs had suffered injuries and were aware of their injuries at the time of the bankruptcy filing.

Under this reasoning, if a debtor is aware of a defective product it manufactured, a site it polluted or some other circumstance in which it may face liability, it should engage in a two-step process. First, it should give actual notice of the bankruptcy proceeding to known purchasers or users of the product, known abutters, or others with foreseeable claims. Then, reasonably foreseeable claimants who are reasonably ascertainable should receive actual notice, while claimants who are not reasonably ascertainable should receive constructive notice. Although Judge Sarokin's concurrence sets forth an alternative framework for determining who is entitled to notice, the concurrence does not tackle the key issue: can the due process rights of an individual who has suffered no injury be satisfied by providing notice (either actual or constructive) to him that it is reasonably foreseeable that an injury may occur as a result of the debtor's conduct? Judge Sarokin views this type of notice as an effort to protect the due process rights of creditors whose claims may later be barred and at least preferable to providing no notice. As noted above, however, it is not at all clear that unknown, future claims are properly dischargeable. Regardless of the outcome of that debate, it is costly and, perhaps, delusional, to believe that due process can be satisfied by providing, in essence, meaningless notice.

Bankruptcy Judge Schmetterer zeroed in on this point in his recent decision in Kewanee Boiler Corp. v. Smith (In re Kewanee Boiler Corp.), 198 B.R. 519, 530 (Bankr. N.D. Ill. 1996) ("[N]o meaningful notice can be given to individuals who do not yet know they suffer from injury."). In that case, twenty months after confirmation, a boiler manufactured by the debtor in 1952 allegedly malfunctioned causing plaintiff injury. Plaintiff filed a complaint in state court against the reorganized debtor, which in turn filed an adversary proceeding in the bankruptcy case seeking an order enjoining plaintiff from collecting on his claim outside of the bankruptcy case and determining that plaintiff held a pre-petition claim that had been discharged in connection with the confirmation of the plan of reorganization.

The Bankruptcy Court, weighing in on the future claims issue, concluded that, despite the broad definition of the term "claim" in the Bankruptcy Code, plaintiff had no such claim because he had no right to payment "at any time prior to Debtor's confirmation and therefore had no pre-petition or pre-confirmation claim under [§ 101(5)]." Moreover, the Court held that even if plaintiff could be deemed to hold some sort of contingent claim, constitutional issues of due process would be implicated that would bar efforts to enjoin him. The Court noted the impossibility of providing any meaningful notice to people who do not yet know they suffer from an injury and that, in any event, no such notice was attempted.

The Court also noted that the confirmed plan did not take steps to limit its liability to future tort victims through any special provision for them in the plan. No fund was provided for distribution to these future claimants. No claims were ever filed on behalf of possible future claimants and a legal representative was not appointed. The plan itself never expressly provided for payment to a future class of claimants who had at that time not been injured by the products manufactured before bankruptcy was filed, but would or might be injured thereafter.

> Because no such provision was made in the Plan, and because future victims of torts were not represented in the bankruptcy or noticed, these persons cannot be forced into participating in the limited distribution that unsecured creditors are entitled to receive under the Plan here. Whether [plaintiff] had a claim under Section 101(5) is doubtful because he had no right to payment prior to confirmation. But even if he did, his right to notice under bankruptcy law and the Constitution were not met.

198 B.R. at 539. See also Fairchild Aircraft Incorporated v. Campbell (In re Fairchild Aircraft Corp.), 184 B.R. 910 (Bankr. W.D. Tex. 1995) (holding that claims made as a result of an aircraft crash did not constitute "bankruptcy claims" of a kind which could be affected by the plan confirmation order because no proof of claim had been filed on behalf of such future claimants, no legal representative had been appointed to protect their interests and there was no assurance that the interests of such future claimants were treated properly in the bankruptcy proceeding).

As the above analysis makes clear, there is no consensus in the courts about who is entitled to what type of notice. Moreover, each case presents a unique fact pattern that leaves room for interpretation of any general rules. In the final analysis, the answer to the question "who gets what notice?" must be based on an analysis that considers the cost of providing additional types of notice to creditors, the risk that notice alone may later be deemed inadequate to have cut off a creditor's rights, and the size of the risk that successor liability claims will materialize.

III. PRACTICE TIPS

The above analysis of the role of notice in cutting off successor liability claims leads to the following general guidelines:

1. Do not derive a false sense of security from a purported disclaimer of successor liability that is not disclosed to the court and the debtor's creditors. The lack of notice will prove fatal if challenged by a party whose rights are affected by the provision. See Savage Arms, 43 F.3d 714.

2. Known creditors must receive actual knowledge of the bankruptcy proceedings and the successor liability disclaimer terms of a proposed acquisition. Notice by mail "is presumed to have been received by the party to whom it has been addressed if it properly addressed, stamped and deposited in the mail." In re Texaco, Inc., 182 B.R. 937, 954 (Bankr. S.D.N.Y. 1995).

3. Failure to provide actual notice to known creditors will not be excused on the grounds that the creditor was aware of the bankruptcy proceedings through other

means. Levin v. Maya Construction (In re Maya Construction Company), 78 F.3d 1395, 1399, petition for cert. filed (July 3, 1996) (9th Cir. 1996) ("The fact that a creditor has actual knowledge that a Chapter 11 bankruptcy proceeding is going forward involving a debtor does not obviate the need for notice.").

4. The steps taken to search for known creditors from the debtor's own books and records should be well-documented. Steps considered (including investigations beyond the debtor's books and records such as title searches) but not taken because of cost or impracticability should also be documented. Build a record that demonstrates that reasonably diligent efforts were taken to obtain the identities of possible creditors. Remember that "impracticable and extended searches are not required in the name of due process." Mullane, 339 U.S. at 317-18. Although Chemetron holds that the search should focus on the debtor's own books and records, 72 F.3d at 347, the debtor is obligated "to undertake more than a cursory review of its records and files to ascertain its known creditors." Texaco, 182 B.R. at 955. Consider whether the particular circumstances justify additional efforts beyond a review of the debtor's own files. Are other creditors reasonably foreseeable? If their identities are reasonably ascertainable, provide them with actual notice. If not, consider providing constructive notice in a manner reasonably calculated to reach them.

5. Provide notice to unknown creditors by publication that is reasonably calculated to apprise all interested parties of the pendency of the action. Notice need not be published in every newspaper a possible unknown creditor may read. Publication in national newspapers such as *The New York Times* and *The Wall Street Journal* together with notice in papers of general circulation in locations where the debtor conducts business has generally been considered adequate. Publication of notice should also be made in any journals and newspapers or by other means reasonably linked to possible unknown claimants. Although such notice may be meaningless, the fact that notice was at least attempted may be a factor that will help a court determine that due process has been satisfied. See Kewanee, 195 B.R. at 538.

6. The due process rights of unknown claimants may also be protected through a legal representative appointed in the bankruptcy proceeding to protect the interests of potential, future, foreseeable claimants. Thus, although notice is, unquestionably, the first step in cutting off successor liability claims, further steps should be considered where notice would be meaningless. Several opinions such as Fairchild Aircraft note that the appointment of a legal representative is one manner in which the due process rights of future creditors may be satisfied.

303979.c13