

# DELAWARE LAW REVIEW

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*Joel Edan Friedlander*

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## THE DESEGREGATION DECREES OF THE DELAWARE COURT OF CHANCERY

Joel Edan Friedlander\*

*It is often said that the United States Supreme Court affirmed Chancellor Collins J. Seitz in *Brown v. Board of Education*, but the legal history is more complex than that. Chancellor Seitz's decision in *Belton v. Gebhart and Bulah v. Gebhart* was simultaneously historic, influential, and disregarded as a model for desegregation. In this essay, I discuss how Chancellor Seitz's decision and decree can be seen as representing an alternative model for desegregation based on a more traditional form of equity jurisprudence. I examine Chancellor Seitz's approach to desegregation by examining *Belton/Bulah* within the context of three other challenges to racial segregation adjudicated by the Delaware Court of Chancery in the decade between 1950 and 1959. The manner by which Chancellor Seitz and Vice Chancellor Marvel discharged their judicial oath in these four cases is worthy of study and honor several decades later.*

On April 1, 1952, Chancellor Collins J. Seitz issued a post-trial opinion in the consolidated actions *Belton v. Gebhart and Bulah v. Gebhart* (“*Belton/Bulah*”). Chancellor Seitz concluded, based on the testimony of expert witnesses, that segregation laws harmed Black students: “in our Delaware society, State-imposed segregation in education itself results in the Negro children, as a class, receiving educational opportunities which are substantially inferior to those available to white children otherwise similarly situated.”<sup>1</sup>

Two weeks later, Chancellor Seitz ordered the desegregation of Claymont High School and Hockessin School No. 29. He enjoined the State Board of Education “from denying to infant plaintiffs and others similarly situated, because of color or ancestry, admittance as pupils” in those two schools.<sup>2</sup>

Chancellor Seitz's post-trial opinion and implementing order are noteworthy events in American legal history. Chancellor Seitz's factual findings and desegregation decree were left undisturbed on appeal by the United States Supreme Court as part of the consolidated litigation known as *Brown v. Board of Education*. Never had a court *both* adopted the factual basis underlying the challenges to segregated schooling advanced by the NAACP Legal Defense Fund, led by Thurgood Marshall, *and* then ordered the desegregation of a primary school or high school.<sup>3</sup>

In 1954, in the opinion known as *Brown I*, the United States Supreme Court famously declared: “Separate educational facilities are inherently unequal.”<sup>4</sup> One year later, in the opinion known as *Brown II*, the United States

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1. *Belton v. Gebhart*, 87 A.2d 862, 864, *aff'd*, 91 A.2d 137 (Del. 1952), *aff'd sub nom. Brown v. Bd. of Educ. of Topeka, Kan.*, 349 U.S. 294 (1955) (“*Brown II*”).

2. Order at 1-2, *Belton v. Gebhart*, C.A. Nos. 258 & 265 (Del. Ch. Apr. 15, 1952).

3. Neither the factual finding nor the form of injunction decree was unprecedented. Months earlier, a three-judge court sitting in the U.S. District Court for the District of Kansas had ruled against the plaintiffs under the “separate but equal” standard, but nonetheless made the (unpublished) factual finding that segregation “in public schools has a detrimental effect upon the colored children.” *Brown v. Bd. of Ed. of Topeka, Shawnee Cnty., Kan.*, 98 F. Supp. 797 (D. Kan. Aug. 3, 1951) (full text available in <https://www.famous-trials.com/brown/>), *quoted in* *Brown v. Bd. of Ed. of Topeka, Shawnee Cnty., Kan.*, 347 U.S. 483, 494 (1954) (“*Brown I*”). In an earlier case also litigated by Thurgood Marshall, which involved a town 50 miles away from Topeka, the Kansas Supreme Court held that certain schools had been segregated by race without legal authority under state law and ordered: “Colored and white pupils must be permitted to attend either school, depending on convenience, or some other reasonable basis. In the meantime, pending such action, the colored pupils and all pupils in District No. 90 must be permitted to attend the ‘South Park District School’ beginning with the school year of 1949-50 ....” *Webb v. School District No. 90*, 206 P.2d 1066, 1073 (Kan. 1949).

4. *Brown I*, 347 U.S. at 495.

Supreme Court authorized desegregation decrees “to effectuate a transition to a racially nondiscriminatory school system.”<sup>5</sup> The Supreme Court affirmed Chancellor Seitz’s judgment, which itself had been affirmed by the Delaware Supreme Court, “ordering the immediate admission of the plaintiffs to schools previously attended only by white children.”<sup>6</sup> *Brown II* reversed the contrary decisions of the lower federal courts in Kansas, South Carolina, Virginia, and the District of Columbia, which had been consolidated on appeal with *Belton/Bulah*.

At a memorial tribute, Chancellor Seitz was eulogized by William T. Coleman, Jr., a former law clerk to Justice Felix Frankfurter and later a leading member of Thurgood Marshall’s legal team. Coleman recalled what Justice Frankfurter had told him about the significance of Chancellor Seitz’s opinion and decree in *Belton/Bulah*:

I’d really like to bump into that young fellow Seitz some day and tell him exactly what he did, which greatly influenced the case which we now know as *Brown versus Board of Education*. First, he said, you have to realize that there were five decisions which had held that segregation was constitutional and giants at the law like Holmes, Brandeis, and Stone had voted that way. Next, you had to realize that Chancellor Seitz was the first person as a jurist, not as an advocate, to put in writing why in 1952 that segregated schools were completely inconsistent with the American dream. For Frankfurter, it was quite significant that this was done by a state court judge. The judge, moreover, was a son of Delaware, the first state to adopt the United States Constitution, which, as you know, unfortunately, had that horrible clause counting Negroes as only three-fifths of a person, and that is the evil that *Brown* finally put to the end. He was also a son of a state which bordered on the south and a graduate of a law school in the south. Particularly important to Justice Frankfurter was that the decision was by a Chancellor, which, as we know, since soon after *Runnemedes*, had the responsibility to eliminate carefully and skillfully the sharp and unfair edges of the common law, and to do away with ancient destructive practices of a radically different type in a radically different past. These assets all combined in that young person Seitz, Frankfurter concluded, and demonstrated that history, including legal precedents of the Supreme Court, could be made to bow before the sheer stubbornness of a human conscience.<sup>7</sup>

It is often said that the United States Supreme Court “affirmed” Chancellor Seitz, but the legal history is more complex than that. The holdings and desegregation decree of Chancellor Seitz respecting Claymont High School and Hockessin School No. 29 differ markedly in various ways from the decisions issued by the Supreme Court in *Brown I* and *Brown II*.

First, Chancellor Seitz issued his desegregation decree while applying the legal regime of “separate but equal,” as established by the United States Supreme Court in *Plessy v. Ferguson*.<sup>8</sup> Chancellor Seitz rejected the legal argument, preserved for appeal, that “State-imposed segregated education on the grammar and high school levels, in and of itself,” violates the Fourteenth Amendment.<sup>9</sup> Chancellor Seitz ruled in favor of the plaintiffs on the alternative ground that Claymont High School offered superior facilities and educational opportunities as compared to Howard High School and Carver Vocational School, and that Hockessin School No. 29 was superior to Hockessin School No. 107. The United

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5. *Brown II*, 349 U.S. at 300-01.

6. *Id.* at 301.

7. *Federal Judge Tribute: Remarks of William T. Coleman Jr.*, C-SPAN (Jan. 29, 1999) [hereinafter *Coleman Remarks*], at <https://www.c-span.org/video/?119978-1/federal-judge-tribute>.

8. 163 U.S. 537 (1896).

9. *Belton v. Gebhart*, 87 A.2d 862, 865, *aff’d*, 91 A.2d 137 (Del. 1952), *aff’d sub nom. Brown v. Bd. of Educ. of Topeka, Kan.*, 349 U.S. 294 (1955).



States Supreme Court declared that segregated schooling was unconstitutional, rejecting lower court rulings in other jurisdictions that segregated schools either were comparable or must be made equal.

*Second*, Chancellor Seitz's desegregation decree was limited to prohibiting racial discrimination in the admission of students to specific schools. This form of relief exemplified what could be described as a traditionalist approach to doing equity, in which the equitable rights of plaintiffs are vindicated through a precisely worded order. In *Brown II*, the United States Supreme Court authorized an innovative remedy that became known as a structural injunction, by which judges remade entire school districts and school systems, or similar public bodies, through judicial supervision of governmental administrators.<sup>10</sup> In the words of *Brown II*, judges could issue decrees that addressed "problems related to administration, arising from the physical condition of the school plant, the school transportation system, personnel, revision of school districts and attendance areas into compact units to achieve a system of determining admission to the public schools on a nonracial basis, and revision of local laws and regulations[.]"<sup>11</sup>

*Third*, as Coleman noted in his eulogy, the United States Supreme Court reversed Chancellor Seitz about the timetable for imposing equitable relief:

And therefore, once again, [Chancellor Seitz] ordered forthwith ... but the fact is that the Supreme Court of the United States, that case did get reversed, because on the decree he had moved too fast. And the court said "with all deliberate speed" rather than "forthwith."<sup>12</sup>

The Supreme Court's phraseology "with all deliberate speed" meant that desegregation required localized litigation against obstinate local officials over a period of decades.

*Fourth*, Chancellor Seitz ordered immediate desegregation as to the named plaintiffs "and others similarly situated" with respect to the individual schools in question. The United States Supreme Court affirmed Chancellor Seitz's decree as to the named plaintiffs only, and otherwise remanded the case to the Delaware Supreme Court. The fashioning of new school admission policies applicable to "similarly situated" Black students was left to local authorities under local judicial supervision.

These aspects of *Brown I* and *Brown II* show how Chancellor Seitz's decision in *Belton/Bulah* was simultaneously historic, influential, *and* disregarded as a model for desegregation. The United States Supreme Court opted not to authorize on a local or national scale Chancellor Seitz's remedy of prohibiting race discrimination when evaluating admissions to local all-white schools. Over time, the United States Supreme Court enforced with greater stringency its preferred model of gradual desegregation through structural injunctions.<sup>13</sup>

In this article, I discuss how Chancellor Seitz's decision and decree can be seen as representing an alternative model for desegregation based on a more traditional form of equity jurisprudence. I examine Chancellor Seitz's approach to desegregation by examining *Belton/Bulah* within the context of three other challenges to racial segregation adjudicated in the Delaware Court of Chancery in the decade between 1950 and 1959. Then, as now, the Delaware Court of Chancery was a tribunal best known for applying equitable principles in corporate law disputes. The four cases show how two judges

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10. See ROSS SANDLER & DAVID SCHOENBROD, *DEMOCRACY BY DECREE: WHAT HAPPENS WHEN COURTS RUN GOVERNMENT* (2003) (discussing the use of structural injunctions after *Brown II*); PETER CHARLES HOFFER, *THE LAW'S CONSCIENCE: EQUITABLE CONSTITUTIONALISM IN AMERICA* xii (1990) (arguing that *Brown II* and subsequent mandatory injunctions are "very good constitutional equity"); GARY L. MCDOWELL, *EQUITY AND THE CONSTITUTION: THE SUPREME COURT, EQUITABLE RELIEF, AND PUBLIC POLICY* (1982) (arguing that *Brown II* and subsequent structural injunctions are inconsistent with the history of equity).

11. *Brown II*, 349 U.S. at 300-01.

12. *Coleman Remarks*, *supra* note 7.

13. See, most notably, *Green v. County School Board of New Kent County, Virginia*, 391 U.S. 430, 437-38 (1968), which held that school boards "operating state-compelled dual systems were nevertheless clearly charged with the affirmative duty to take whatever steps might be necessary to convert to a unitary system in which racial discrimination would be eliminated root and branch," and *Swann v. Charlotte-Mecklenburg Board of Education*, 402 U.S. 1 (1971), which endorsed a remedial plan of city-suburban busing.

on the same trial court similarly determined to do equity when no state or federal legislation created a legal entitlement for the plaintiffs, no precedent from the United States Supreme Court provided a roadmap for desegregation, local political support was wholly lacking, and the Delaware Supreme Court had not spoken.

In each of the four cases, the Delaware Court of Chancery granted relief to the plaintiffs. The relief granted was immediately enforceable by the plaintiffs to provide relief from segregation.

## I. FOUR DELAWARE DESEGREGATION DECREES

All four decisions were controversial. Ruling for the plaintiffs required professional courage by trial judges who lacked lifetime tenure. The Delaware Supreme Court reversed two of the decisions. Two of the decisions led to landmark rulings by the United States Supreme Court.

The first two cases were decided by Collins Seitz, the first in his capacity as Vice Chancellor and the second in his capacity as Chancellor. The latter two were decided by then-Vice Chancellor William Marvel. Notwithstanding their long, distinguished judicial careers—Seitz later served as Chief Judge of the Court of Appeals for the Third Circuit, and Marvel as Chancellor—both are remembered best for their respective rulings in these four cases.<sup>14</sup>

The first case was *Parker v. University of Delaware*.<sup>15</sup> Vice Chancellor Seitz was assigned the case because Chancellor Harington was a member of the board of trustees of the University of Delaware.<sup>16</sup> As the case progressed, Vice Chancellor Seitz was under consideration to succeed Chancellor Harington as Chancellor. Despite the risk to his career,<sup>17</sup> Vice Chancellor Seitz enjoined the University of Delaware from denying admission to Black students on the basis of their race, based on factual findings respecting the inferior educational opportunities at Delaware State College. His decision was not appealed.

Soon thereafter, Chancellor Seitz decided *Belton/Bulah*, which became part of *Brown I* and *Brown II*.

At the beginning of the school year following *Brown I* eleven Black students were voluntarily admitted to Milford High School, only to be expelled weeks later by a new school board following mass demonstrations against integrated schooling, which made national news.<sup>18</sup> In his very first published opinion,<sup>19</sup> Vice Chancellor Marvel issued a preliminary mandatory injunction requiring re-admission of the Black students.<sup>20</sup> His injunction was reversed on appeal, on the basis that *Brown I* had not required immediate desegregation and the State Board of Education had issued a binding directive after *Brown I* prohibiting local school boards apart from the Wilmington Board of Education from desegregating schools unilaterally.

In 1959, in *Burton v. Wilmington Parking Authority*, Vice Chancellor Marvel granted “a declaratory judgment in the form of injunctive relief” that it was a violation of the Equal Protection Clause for a coffee shop that leased space from

14. Wolfgang Saxon, *Judge Collins Seitz Dies at 84; Refuted Segregation in Schools*, N.Y. TIMES, at C27 (Oct. 21, 1998); William Marvel, 81, *Judge in Delaware's Bias Cases of 1950's*, N.Y. TIMES, at B5 (July 10, 1991) [hereinafter *Marvel Obituary*].

15. 75 A.2d 225 (Del. Ch. 1950).

16. *A Conversation with Judge Collins J. Seitz, Sr.*, 16 DEL. LAW. No. 3, at 29 (Fall 1998), available at <https://delawarebarfoundation.deltaboston.com/all-documents/delaware-lawyer-magazine/1998-volume-16/61-volume16-number3-fall1998/file> [hereinafter *Conversation with Judge Seitz*].

17. See William J. Brennan Jr., *The Courage of Collins Seitz*, 40 VILL. L. REV. 547, 548-59 (1995).

18. *Education: Racial Flare-Up*, TIME (Oct. 11, 1954), available at <https://content.time.com/time/subscriber/article/0,33009,936456,00.html>; Selwyn James, *The Town That Surrendered To Hate*, 104 REDBOOK 70 (Apr. 1955).

19. William T. Quillen and Michael Hanrahan, *A Short History of the Court of Chancery, 1792-1992* (1993), at <https://courts.delaware.gov/chancery/history>.

20. *Simmons v. Steiner*, 108 A.2d 173 (Del. Ch. 1954), *rev'd*, 111 A.2d 574 (Del. 1955).

the Wilmington Parking Authority to deny admittance to Black would-be customers.<sup>21</sup> His decision was reversed by the Delaware Supreme Court. The United States Supreme Court reversed the Delaware Supreme Court and adopted the reasoning of Vice Chancellor Marvel.

*Belton/Bulah* remains a source of pride for Delaware's bench and bar. Chancellor Seitz's order on blue-backed paper, with his interlineations and signature, is preserved at the Delaware Public Archives, with a copy put on public display by the Delaware Court of Chancery. What is less appreciated is that Chancellor Seitz's order typifies a consistent approach to desegregation for the Delaware Court of Chancery in that era.

The four cases are discussed more fully below.

### A. *Parker v. University of Delaware*

Very late in his life, then-Judge Seitz described *Parker v. University of Delaware* as "an easy case":

In *Parker v. University of Delaware*, the plaintiff had named the board of trustees of the University of Delaware as defendants too. Chancellor Harrington was on the board, so he couldn't take the case and it fell to me. That was an easy case. It was decided under the separate but equal doctrine. And to compare the University of Delaware with Delaware State College at that time was sort of ludicrous. I visited both universities before I decided the case and the opinion sets forth the disparities. As I say, it was easy.<sup>22</sup>

The case was only "easy" because Vice Chancellor Seitz was fearless in applying a longstanding legal standard to a set of observable facts, and then awarding a novel remedy that chipped away at the edifice of segregated schooling. Vice Chancellor Seitz's ruling was the first decision in the country to result in the immediate admission of Black students to an otherwise white undergraduate program.<sup>23</sup>

Ruling against the University of Delaware meant ruling against the political and legal establishment of the State of Delaware. The Board of Trustees of the University of Delaware included eight individuals appointed by the Governor and twenty individuals elected by the Board, all of whom were subject to Senate confirmation. The Governor and the President of the State Board of Education were trustees *ex officio*.<sup>24</sup> So was the Chancellor. The University of Delaware was represented in the case by Delaware's Attorney General.

Ruling against the University of Delaware meant ruling against actions taken by the current trustees. The University of Delaware was not segregated as a matter of some longstanding statute. The plaintiffs were challenging a resolution adopted by the Board of Trustees on January 31, 1948, several months after Jackie Robinson broke the color barrier in Major League Baseball and several months before President Truman ordered the desegregation of the military. That board resolution permitted the admission of Black students, subject to the condition that "a course of study leading to the same degree is not furnished in any educational institution provided by this State within this State for the education of bona fide colored residents of this State."<sup>25</sup> In February 1950, the Board of Trustees resolved not to provide requested

21. 150 A.2d 197, 198 (Del. Ch. 1959), *rev'd*, 157 A.2d 894 (Del. 1960), *rev'd*, 365 U.S. 715 (1961).

22. *Conversation with Judge Seitz, supra* note 16, at 29.

23. *Id.* at 30; Louis L. Redding, *Desegregation in Higher Education in Delaware*, 27 J. NEGRO EDU. 253, 253 (Summer 1958) (noting that *Parker* was "the first judicial decision of a segregation case on the undergraduate college level," and that Vice Chancellor Seitz's opinion "received wide and prominent notice from the usual media of public information, was reprinted privately, and extensively distributed throughout Delaware").

24. *Parker v. University of Delaware*, 75 A.2d 225, 229 (Del. Ch. 1950).

25. *Id.* at 226.

admission application forms to Black students, notwithstanding the fact that Delaware State College had lost its accredited status.<sup>26</sup>

The Vice Chancellor “assume[d], without deciding, that the Trustees of the University were entitled under Delaware law to refuse admission to these Delaware Negroes solely because of their race.”<sup>27</sup> Plaintiffs challenged the Trustees’ action under the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution. Plaintiffs sought injunctive relief requiring the admission of qualified Black students:

a permanent injunction restraining defendants from denying to plaintiffs and others similarly situated, the customary blanks upon which application may be made for admission to undergraduate study at the University; restraining the defendants from considering and acting upon the application blanks of plaintiffs and others similarly situated when filled out and returned to the University, upon grounds relating to the color or ancestry of the plaintiffs; restraining the defendants from enforcing a resolution, custom or usage whereby the plaintiffs and others similarly situated are excluded from admission to undergraduate work at the University.<sup>28</sup>

Three defenses were proffered: (i) there was no properly defined class to allow maintenance of a class action; (ii) the University of Delaware was not a state institution subject to the Fourteenth Amendment; and (iii) “the evidence fails to show that the College is unequal to the University.”<sup>29</sup>

As to the first defense, Vice Chancellor Seitz stated that “a class action is particularly appropriate here” because the “basic question to be decided involves the application of one of the great guarantees of the Constitution of the United States—the equal protection of the laws.”<sup>30</sup> He continued: “Many of the students at the College and many of the June graduates of the Negro high schools may properly be considered to be in the class. Yes, the class is real enough.”<sup>31</sup>

Vice Chancellor Seitz concluded that “the University and its Trustees are representatives of the State of Delaware to an extent and in a sense sufficient to apply to them the great restraints required by the Constitution.”<sup>32</sup> The “great restraint” under then-current jurisprudence was *Plessy v. Ferguson* and the legal standard of “separate but equal.” The Plaintiffs asked Vice Chancellor Seitz to rule that a “segregated school ... cannot be an equal school,” but he stated that he did “not believe I am entitled to conclude that segregation alone violates that clause.”<sup>33</sup>

Vice Chancellor Seitz’s application of “separate but equal” was intensely factual. He did not cite any precedent, as if it were unremarkable to be the first judge to hold that a dual system of undergraduate education was unconstitutionally unequal. At points he used strong language:

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26. *Id.*

27. *Id.* at 230.

28. *Id.* at 227.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* at 230.

33. *Id.*

“It is rather shocking that at this stage in the progress of higher education in Delaware many of its citizens do not have available to them in their college work anything resembling seminar courses.”<sup>34</sup>

“One cannot but note the shocking lack of tenure at the College.”<sup>35</sup>

“The College is woefully inferior to the University in the physical facilities available to and in the educational opportunities offered its undergraduates in the School of Arts and Science.”<sup>36</sup>

The Vice Chancellor’s factual findings led him to conclude that a particular remedy was appropriate, without any discussion of potential alternative remedies.

It follows from my conclusions that the Trustees of the University by refusing to consider plaintiffs’ applications because they are Negroes have violated the guarantee contained in the Equal Protection Clause of the United States Constitution. The plaintiffs are therefore entitled to a permanent injunction in accordance with the prayers of their complaint.<sup>37</sup>

The decision to grant the requested injunction meant that the University of Delaware could no longer discriminate on the basis of race in admissions, which enabled Black students to be admitted for the following school year.<sup>38</sup>

In an interview late in life, then-Judge Seitz explained that he had awarded an injunction in the traditional form, which could be seen as modest in scope:

I decided that the University of Delaware could not consider color when passing on admissions, not that I ordered them admitted. That may sound like a distinction without a difference to some people, but that’s really the typical equitable form of injunction. So that, in effect, they then apply for admission on their merits like anyone else.<sup>39</sup>

Judge Seitz further explained that his choice of remedy was innovative for the subject matter, and is part of what distinguished him from other judges, who were more sympathetic to maintaining racial segregation:

That was the typical approach to segregation in all of those cases: we may be in default, but give us time. That same thing happened later in *Belton*, that same

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34. *Id.* at 232.

35. *Id.*

36. *Id.* at 234.

37. *Id.*

38. See Redding, *supra* note 23, at 253 (“A few days later some of the plaintiffs enrolled and in due course were graduated.”).

39. *Conversation with Judge Seitz, supra* note 16, at 29.

argument was made. That's the difference between my decision and a lot of the others.<sup>40</sup>

The alternative remedy that Vice Chancellor Seitz rejected—as summarized by the phrase “we may be in default, but give us time”—was a structural injunction to improve the quality of segregated all-Black schools. That alternative remedy could entail further injunctions to require additional government funding of Delaware State College, which could require judicial review of the budgeting process, or orders that the State issue bonds or raise taxes. It would also require judicial oversight of the operations of Delaware State College over a period of years, to compare various facets of the school to the University of Delaware. It would entail mandating governmental action to create a school that did not exist—an accredited college for an all-Black student body, with facilities, faculty, student support services, and educational opportunities comparable to those at the University of Delaware. In practice, the alternative remedy of a structural injunction would order the creation of a legally defensible simulacrum.

Judge Seitz explained why he chose to grant the injunction requested by the plaintiffs in *Parker*, which was the same type of remedy he later granted in *Belton/Bulah*:

I haven't read my *Belton* opinion in a long, long time, but I think I said why in that opinion, that the Constitution on equal protection didn't say it was to be deferred for some students. It was to apply to all students. When they could come back and show that it applied to all students, then maybe we would have a different problem. Otherwise, we weren't to wait to educate their grandchildren.<sup>41</sup>

The Equal Protection Clause had been interpreted by the United States Supreme Court as requiring separate but equal education. The State of Delaware had defaulted on that obligation. Vice Chancellor Seitz's chosen remedy was to grant the plaintiffs before him, and those similarly situated, an equal education in fact, by means of the formally modest remedy of forbidding their exclusion from all-white schools.

### B. *Belton v. Gebhart; Bulah v. Gebhart*

The Plaintiffs in *Belton* were Black students who had been refused admission to Claymont High School. They were permitted to attend either Howard High School or Carver Vocational School, both of which were located approximately nine miles from the residence of one of the plaintiffs. The Plaintiff in *Bulah* was a seven year old residing near Hockessin who was refused admission to Hockessin School No. 29.

Delaware law required “that there be separate free school systems for Negroes and whites.”<sup>42</sup> A striking aspect of Chancellor Seitz's decision is his consideration of plaintiffs' evidentiary case that “legally enforced segregation in education, in and of itself, prevents the Negro from receiving educational opportunities which are ‘equal’ to those offered whites.”<sup>43</sup> Chancellor Seitz summarized:

Plaintiffs produced many expert witnesses in the fields of education, sociology, psychology, psychiatry and anthropology. Their qualifications were fully established. No witnesses in opposition were produced. One of America's foremost psychiatrists testified that State-imposed school segregation produced in Negro

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40. *Id.*

41. *Id.*

42. *Belton v. Gebhart*, 87 A.2d 862, 864, *aff'd*, 91 A.2d 137 (Del. 1952), *aff'd sub nom. Brown v. Bd. of Educ. of Topeka, Kan.*, 349 U.S. 294 (1955).

43. *Id.*

children an unsolvable conflict which seriously interferes with the mental health of such children.

... The other experts sustained the general proposition as to the harmful over-all effect of legally enforced segregation upon Negro children generally.... The fact is that such practice creates a mental health problem in many Negro children with a resulting impediment to their educational progress.<sup>44</sup>

Chancellor Seitz rejected the defense that Delaware's white population would not accept integrated schooling:

Defendants say that the evidence shows that the State may not be 'ready' for non-segregated education, and that a social problem cannot be solved with legal force. Assuming the validity of the contention without for a minute conceding the sweeping factual assumption, nevertheless, the contention does not answer the fact that the Negro's mental health and therefore, his educational opportunities are adversely affected by State-imposed segregation in education. The application of Constitutional principles is often distasteful to some citizens, but that is one reason for Constitutional guarantees. The principles override transitory passions.

I conclude from the testimony that in our Delaware society, State-imposed segregation in education itself results in the Negro children, as a class, receiving educational opportunities which are substantially inferior to those available to white children otherwise similarly situated.<sup>45</sup>

These factual findings did not contribute to Chancellor Seitz's holding. They were made in aid of appeal. Chancellor Seitz proceeded to discuss why, as a matter of law, he was bound by the implication of Supreme Court precedent that "a separate but equal test can be applied, at least below the college level."<sup>46</sup> Chancellor Seitz stated that he believed this legal rule was wrong: "This Court does not believe such an implication is justified by the evidence.... I believe the 'separate but equal' should be rejected, but I also believe its rejection must come from the Court."<sup>47</sup> Chancellor Seitz continued: "It is for that Court to re-examine its doctrine in the light of my finding of fact."<sup>48</sup>

The United States Supreme Court's decision in *Brown I* is famous in part for its footnote 11,<sup>49</sup> which inaugurated the citation of social science research in Supreme Court opinions.<sup>50</sup> Less appreciated is footnote 10, which quotes Chancellor Seitz's post-trial finding for the same proposition—that State-imposed segregation in education results in inferior educational opportunities for Black students.<sup>51</sup>

44. *Id.* (footnote omitted).

45. *Id.* at 864-65.

46. *Id.* at 865.

47. *Id.*

48. *Id.* at 866.

49. *Brown I*, 347 U.S. at 494 n.11.

50. See David L. Faigman, "Normative Constitutional Fact-Finding": Exploring the Empirical Component of Constitutional Interpretation, 139 U. PA. L. REV. 541, 565 nn.88, 92 (1991).

51. *Brown I*, 347 U.S. at 494 n.10.

Chancellor Seitz ruled for the plaintiffs on the basis that the separate schools for the Black plaintiffs were not “equal to those furnished white children similarly situated.”<sup>52</sup> One identified factor was the additional travel time for one Black student, Ethel Louise Belton, a Claymont resident, due to her exclusion from Claymont High.<sup>53</sup> Additionally, Carver Vocational lacked an auditorium, a gymnasium, or a regular cafeteria.<sup>54</sup> Claymont High was superior in the categories of “teacher training, pupil-teaching ratio, extracurricular activities, physical plants and aesthetic considerations.”<sup>55</sup> Chancellor Seitz made similar findings respecting the facilities and educational opportunities of the elementary schools in question.<sup>56</sup>

Chancellor Seitz discussed why he refused to grant an injunction directing the defendants to equalize facilities and opportunities. He offered three reasons:

(1) I do not see how the plans mentioned will remove all the objections to the present arrangement. (2) Moreover, and of great importance, I do not see how the Court could implement such an injunction against the State. (3) Just what is the effect of such a finding of a violation of the Constitution, as has here been made.... If, as the Supreme Court has said, this right is personal, such a plaintiff is entitled to relief immediately, in the only way it is available, namely, by admission to the school with the superior facilities. To postpone such relief is to deny relief, in whole or in part, and to say that the protective provisions of the Constitution offer no immediate protection.<sup>57</sup>

Chancellor stated that “the State’s future plans” provided no defense to the requested relief, and that “[i]f it be a matter of discretion, I reach the same conclusion.”<sup>58</sup> His injunction orders were not stayed pending appeal.

The newly created, constitutionally bipartisan<sup>59</sup> Delaware Supreme Court affirmed Chancellor Seitz. The affirmance has a formal quality that limits its historical significance. Nothing about the Delaware Supreme Court’s opinion criticizes racial segregation by law. It reads as a narrow effort to police the contours of “separate but equal.”

The Delaware Supreme Court did not express any opinion as to the Chancellor’s factual finding of the ill effects of segregated schooling. Chief Justice Sutherland wrote that the Chancellor recognized that his factual finding was

52. Belton v. Gebhart, 87 A.2d 862, 866, *aff’d*, 91 A.2d 137 (Del. 1952), *aff’d sub nom.* Brown v. Bd. of Educ. of Topeka, Kan., 349 U.S. 294 (1955).

53. *Id.*

54. *Id.* at 866-67.

55. *Id.* at 869.

56. *Id.* at 870-71.

57. *Id.* at 869-70 (citation omitted).

58. *Id.* at 870.

59. See Joel E. Friedlander, *Is Delaware’s “Other Major Political Party” Really Entitled to Half of Delaware’s Judiciary?*, 58 ARIZ. L. REV. 1139, 1149-51 (2016) (discussing history of 1951 Delaware constitutional amendments). The constitutional amendments of 1951 did not create a bipartisanship requirement for the Court of Chancery. 48 DEL. LAW c. 109, *available at* <https://legis.delaware.gov/SessionLaws/Chapter?id=32970>. The twin subjects of this article, Collins Seitz and William Marvel, served together as the only members of the Court of Chancery between September 1954 and the expansion of the Court in 1961. Quillen and Hanrahan, *supra* note 19. Before becoming judges, they were both northern Delaware Democrats. Seitz once “wrote the whole Democratic state platform myself.” *Conversation with Judge Seitz*, *supra* note 16, at 26. Marvel was former chairman of the New Castle County Democratic Party. *Marvel Obituary*, *supra* note 14.



immaterial to his legal conclusion and added: “We agree that it is immaterial, and hence see no occasion to review it.”<sup>60</sup> Relatedly, the Delaware Supreme Court did not join the Chancellor’s implicit challenge to the United States Supreme Court to overrule “separate but equal” doctrine. Chief Justice Sutherland wrote: “The question of segregation in the schools, under these authorities, is one of policy, and it is for the people of our state, through their duly chosen representatives, to determine what that policy shall be.”<sup>61</sup>

The Delaware Supreme Court found that the high schools in question were substantively unequal in limited respects.<sup>62</sup> The Delaware Supreme Court also concluded that the elementary schools in question were “substantially unequal.”<sup>63</sup>

As to the remedy, the Delaware Supreme Court agreed with Chancellor Seitz that a decree to equalize the high school facilities would not afford adequate relief, notwithstanding contrary rulings by three-judge courts in federal districts in South Carolina and Virginia.<sup>64</sup> The Chancellor’s injunction requiring plaintiff Bulah’s admission to School No. 29 was also affirmed. The affirmance of the injunctions had a grudging quality:

In affirming the Chancellor’s order we have not overlooked the fact that the defendants may at some future date apply for a modification of the order if, in their judgment, the inequalities as between the Howard and Claymont schools or as between School No. 29 and School No. 107 have then been removed. As to Howard, the defendants, as above stated, assert that when the Howard-Carver changes are completed, equality will exist. The Chancellor apparently thought to the contrary. We do not concur in his conclusion, since we think that that question, if it arises, is one which will have to be decided in the light of the facts then existing and applicable principles of law.<sup>65</sup>

The Delaware Supreme Court also questioned the scope of Chancellor Seitz’s injunction order. The Delaware Supreme Court “express[ed] no opinion whether, as to those ‘similarly situated’ other than the plaintiffs, the judgment is *res judicata* or whether it has force only under the rule of *stare decisis*.”<sup>66</sup>

The defendants appealed to the United States Supreme Court. At oral argument, the Justices wrestled with the significance of Chancellor Seitz’s factual finding respecting segregated schooling and his injunction ordering the admission of the named plaintiffs to the formerly all-white schools. In colloquies with Delaware’s Attorney General, Justice Frankfurter made the following comments about Chancellor Seitz’s fact-finding, his injunction, and his opinion:

“A very powerful finding by the Chancellor.”

“Here is what troubles me. It is asking a great deal of this Court, for one-ninth of this Court, to overrule the judgment of the Chancellor, affirmed by the supreme court of the State, that the equity of the situation requires the decree that they entered.”

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60. Gebhart v. Belton, 91 A.2d 137, 142 (Del. 1952).

61. *Id.*

62. *Id.* at 148.

63. *Id.* at 152.

64. *Id.* at 148-49.

65. *Id.*

66. *Id.*

“If I may say so, it was an unusual opinion, as opinions go.”<sup>67</sup>

On May 17, 1954, the United States Supreme Court handed down its decision in *Brown I*, in which the Court declared: “in the field of public education the doctrine of ‘separate but equal’ has no place. Separate educational facilities are inherently unequal.”<sup>68</sup>

The Court requested further argument on the proper remedy. The potential alternative models of injunctive relief are set forth in the following questions, which the Court had previously posed to the litigants:

4. Assuming it is decided that segregation in public schools violates the Fourteenth Amendment

(a) would a decree necessarily follow providing that, within the limits set by normal geographic school districting, Negro children should forthwith be admitted to schools of their choice, or

(b) may this Court, in the exercise of its equity powers, permit an effective gradual adjustment to be brought about from existing segregated systems to a system not based on color distinctions?

5. On the assumption on which questions 4(a) and (b) are based, and assuming further that this Court will exercise its equity powers to the end described in question 4(b),

(a) should this Court formulate detailed decrees in these cases;

(b) if so, what specific issues should the decrees reach;

(c) should this Court appoint a special master to hear evidence with a view to recommending specific terms for such decrees;

(d) should this Court remand to the courts of first instance with directions to frame decrees in these cases, and if so what general directions should the decrees of this Court conclude and what procedures should the courts of first instance follow in arriving at the specific terms of more detailed decrees?<sup>69</sup>

New litigation in the Delaware Court of Chancery would require the application of *Brown I* before the United States Supreme Court answered these questions.

### C. *Simmons v. Steiner*

On June 9, 1954, Delaware’s Attorney General addressed a letter to the President of the State Board of Education respecting *Brown I*. It read in part:

The opinion is not self-executing and does not call for immediate integration. It is possible for any school district, however, where circumstances permit and the situation warrants, to effect integration as now announced by the recent Supreme Court opinion without doing violence to the Constitution and laws of our own States, notwithstanding the fact that the mandate of the United States Supreme Court has not yet been handed down.

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67. *Gebhart v. Belton*, No. 448, Transcript of Oral Argument (Dec. 11, 1952) (afternoon session), available at [lonedissent.org/transcripts/pre-1955/brown1/gebhart-v-belton](http://lonedissent.org/transcripts/pre-1955/brown1/gebhart-v-belton).

68. *Brown I*, 347 U.S. at 495.

69. *Id.* at 495 n.13.

On the other hand, the State Board of Education may well require time within which to bring about integration in an orderly fashion within the spirit and meaning of the recent Supreme Court decision. I am sure that the Board will formulate some concrete plan directed towards an effective gradual adjustment from existing segregation in the public schools in Delaware to a system of non-segregation in accordance with the spirit, purposes and intent of the opinion as expeditiously as it is possible for it to do so.<sup>70</sup>

On June 11, 1954, the State Board of Education announced a policy by which “the actual carrying out of the integrative process will require a longer period of time in some parts of the State than in others.”<sup>71</sup> Only the Wilmington Board of Education was granted permission to “move promptly in the direction of integration.”<sup>72</sup>

On August 19, 1954, the State Board of Education promulgated further regulations, including the following: “No pupils, except those with proper transfer permits shall be accepted by any school from other schools unless and until plans from that school for desegregation in that area have been approved by the State Board of Education.”<sup>73</sup> On August 26, 1954, the State Board of Education listed a number of suggestions “designed as a guide to local boards in arriving at a proposal for ending segregation in the respective school districts.”<sup>74</sup>

On September 8, 1954, eleven Black students were admitted to the previously all-white Milford High School, despite the Milford Special School District never having submitted a desegregation plan to the State Board of Education.<sup>75</sup> Milford is in southern Delaware, which is below the Mason-Dixon line. A typed chronology prepared decades later by the co-author of a book on the subject<sup>76</sup> describes how a mob succeeded in undoing the voluntary limited integration of Milford High School:

Friday, Sept. 17	Mass Meeting at the American Legion to protest integration – Petition circulated to request School Board to re-consider integration – presented to School Board at some point next week
Monday, Sept. 20 to Friday, Sept. 24	Milford schools officially closed due to fear of violence
Tuesday, Sept. 21	Harry Mayhew resigns from School Board
Thursday, Sept. 23	Citing lack of support from State School Board, remaining members of Milford School Board resign, i.e., Ida Phillips, Wm. V. Sipple, and Dean Kimmel, President
Friday, Sept. 24	Governor Boggs orders schools to be reopened under the State Board Spokesman for Negro students says they will attend

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70. *Steiner*, 111 A.2d at 580-81.

71. *Id.* at 581.

72. *Id.*

73. *Id.* at 582.

74. *Id.*

75. *Id.* at 575, 583.

76. ORLANDO J. CAMP & ED KEE, *THE MILFORD ELEVEN* (2011).

Sunday, Sept. 26	Rally at Harrington Airport, Bryant Bowles of NAAWP [National Association for the Advancement of White People] was present and receives first mention in <u>The Milford Chronicle</u> on Oct. 1
Monday, Sept. 27	Schools re-opened; 3-500 adults present for the opening; Dr. George R. Miller, State Superintendent, was present
Thursday, Sept. 30	Newly created Board, consisting of Edmund F. Steiner, George A. Robbins, George P. Adams, and David B. Greene, meets and votes to remove the 11 Negro students from the rolls, effective 3:10 P.M., Sept. 30 Appeals to all constituents of the District to send their children to school on Friday, October 1. Prior to this attendance was cited by <u>The Milford Chronicle</u> to be 31.9%
Sunday, Oct. 10	Mass Meeting at Harrington Airport with Bowles, who is out on bail from charges relating to disrupting De. School Laws <sup>77</sup>

Amidst the unfolding events listed above, Delaware's Attorney General delivered a revised legal opinion respecting *Brown I* to the State Board of Education on September 23, 1954. It stated in part:

At the conference called by the Governor held in my office yesterday afternoon, I was asked whether the Board of the Milford Special School District had acted within the law in admitting the eleven Negro children to the white school in its district. My answer was and is in the affirmative.

In so doing, the Milford Special School District did not violate any constitutional provision, Federal or State, or any State law.

Finally, on either count, first, under the United States Supreme Court Opinion, which nullifies our constitutional provision and its statutory counterpart with regard to the separate but equal doctrine in secondary education in our State, since it contravenes the Federal Constitution, and, secondly, facilities not being equal under our own State law and its judicial decisions, the Board of the Milford Special School District acted in accordance with the law of this State and the law of the land in admitting the eleven Negro pupils to the white school in its district.<sup>78</sup>

Louis Redding filed suit in the Delaware Court of Chancery on behalf of the eleven Black students who had been removed from the records of Milford High School. The plaintiffs moved for a preliminary mandatory injunction that they

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77. Ed Kee, *1954 In the Milford School District A Chronology* (Feb. 27, 1994), Delaware Public Archives (on file with the author). The events in Milford are also recounted in June Shagaloff, *Desegregation of Public Schools in Delaware*, 24 J. NEGRO EDU. 188, 195-201 (Summer 1955).

78. *Steiner*, 111 A.2d at 583-84.

be readmitted.<sup>79</sup> The complaint alleged that the plaintiffs had been removed from Milford High School solely due to their race and that no school facilities near Milford were equal to those afforded by Milford High School.<sup>80</sup>

Vice Chancellor Marvel granted the requested injunction. He reasoned that the plaintiffs were “equitably entitled” to an education at Milford High School, notwithstanding the pending remedy proceedings in the United States Supreme Court:

In light of the sweeping declaration of the Supreme Court on the unqualified right of all persons to a public school education in which race plays no part, it necessarily follows that plaintiffs and those similarly situated are equitably entitled to an education at Milford High School. Under the facts of this case how long must plaintiffs wait?

....

[Defendants’] argument overlooks the fact that whether eventual decrees in the decided cases are *res judicata* for those similarly situated or merely bear the force of *stare decisis*, the Court has given its decision, and decrees were withheld only because they will have wide applicability under a great variety of local conditions. The Supreme Court evidently was of the opinion that it could not without further argument and consideration frame decrees having a broad compulsory scope. This Court at this stage is concerned solely with the constitutional rights of ten students to continue their education at a school to which they had been admitted during a period of permissive integration.

....

I hold that plaintiffs, having been accepted and enrolled, are entitled to an order protecting their status as students of Milford High School; that their right to a personal and present high school education having vested on their admission, they need not wait for decrees in the cases decided by the United States Supreme Court in May as a prerequisite to the relief they seek.

....

I hold that plaintiffs’ constitutional rights to a non-segregated education vested on their admission to Milford High School, rights which defendants concede but wish to withhold for the present. I find plaintiffs’ legal right ‘clear and convincing’, that they are entitled to mandatory relief, and that any inconvenience or distress to defendants must give way before the much greater injury which would be inflicted on plaintiffs by denial of their personal and present rights.<sup>81</sup>

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79. A casebook on remedies includes an excerpt of *Cooling v. Security Trust Co.*, 49 A.2d 121 (Del. Ch. 1946) (Seitz, V.C.), for the authority of an American court of equity to issue a preliminary mandatory injunction. EDWARD D. RE & JOSEPH R. RE, *CASES AND MATERIALS ON REMEDIES* 273-75 (4th ed. 1996).

80. *Simmons v. Steiner*, 108 A.2d 174-75 (Del. Ch. 1954), *rev’d*, 111 A.2d 574 (Del. 1955). The filing of *Simmons* was an exception to the policy of Delaware’s NAACP, which “followed the national policy of giving local school boards a reasonable period of time to evidence their ‘good faith’ in complying with” *Brown I* and then *Brown II*. June Shagaloff, *Public School Desegregation in Delaware*, 25 J. NEGRO EDU. 221, 235 (Summer 1956). In the immediate aftermath of *Brown I*, NAACP branches in Delaware “filed petitions signed by local Negro parents with almost every sizeable white school district in all three counties requesting compliance with the decision. A few local school boards indicated that desegregation was being considered for the following September. Others stated that there would be no change in the segregation policy or made no reply at all.” *Id.*

81. *Id.* at 175-76.

In a footnote, Vice Chancellor Marvel stated that he attached “no legal significance” to the absence of prior approval of the Delaware State Board of Education to the local school board’s plan to admit the plaintiffs to Milford High School, citing the Attorney General’s advice of September 23.<sup>82</sup>

Vice Chancellor Marvel’s opinion followed the model of *Parker* and *Bulah/Belton*. It granted an injunction prohibiting school officials from denying the admission of Black students from attending a local all-white school on account of their race. It depended on case-specific facts. It recognized the equitable rights of the plaintiffs before the Court, who otherwise would attend an inferior school. It did not substitute a future-oriented structural injunction in place of that present relief. It placed more weight on the equitable right of the plaintiffs than on the inconvenience and practical difficulties of the defendants. The granting of an injunction in *Simmons* could be seen as a more obvious form of relief as compared to *Parker* or *Belton/Bulah*, given that *Brown I* had been decided in the interim.

But the granting of an injunction did not logically follow from the procedural posture of *Brown I*. The United States Supreme Court had left open the possibility that “effective gradual adjustment” was a permissible model of injunctive relief, as opposed to Black students being entitled “forthwith [to] be admitted to schools of their choice.”<sup>83</sup> Vice Chancellor Marvel elided the question of which model of injunctive relief was more appropriate by basing his narrow injunction on the case-specific fact that the Milford school board had previously admitted the Milford eleven.

The Delaware Supreme Court delayed the effectiveness of Vice Chancellor Marvel’s injunction. They later vacated it.

The basis for the Delaware Supreme Court’s decision was two-fold. First, the Delaware Supreme Court interpreted *Brown I* as having the following effect: “States having segregation laws are not required, *at the moment*, to desegregate their schools.”<sup>84</sup> Second, the Delaware Supreme Court ruled that the Milford school board had lacked the authority to admit Black students to Milford High School because the regulations propounded by the State Board of Education “directing the local boards to submit plans looking to gradual integration” had the “the force of law throughout the State.”<sup>85</sup>

In summary, the Delaware Supreme Court deferred to State Board of Education regulations forbidding local school boards from unilaterally admitting Black students in geographic areas where the majority local white population was opposed to integration. The Delaware Supreme Court ruled that the original Milford school board members who had been hounded out of office had acted improperly in admitting the Black students, and that the new Milford school board members had acted lawfully in striking the Milford Eleven from the high school rolls:

We are justified in inferring that the State Board’s policy has proved to be a workable one.

We think, therefore, that these regulations are reasonable, and (if we may say so) embody a commendably wise and cautious approach to a problem of great delicacy and difficulty...

....

The lamentable sequence of events suggests the importance of adherence by the local boards to the spirit and letter of the State Board’s regulations....

....

... Certainly the appearance of yielding to threats of violence was most unfortunate. But this circumstance cannot affect the right and duty of the new

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82. *Id.* at 174 & n.2.

83. *Brown I*, 347 U.S. at 495 n.13.

84. *Steiner*, 111 A.2d at 579 (emphasis in original).

85. *Id.* at 576.

Milford Board to comply with the regulations of the State Board. If its action was correct, it must be upheld, whatever reason was assigned for it.<sup>86</sup>

Mass protests, boycotts, and threats of violence had driven school board members out of office and shut down the schools. State school administrators and politicians did nothing. In the face of mob action<sup>87</sup> opposing a limited, voluntary, local effort to integrate Milford High School, the Delaware Supreme Court endorsed as “commendably wise” a ban by State school officials on unilateral local integration as an appropriate means of implementing *Brown I*.

After Vice Chancellor Marvel was reversed for ordering immediate integration as to eleven students, the United States Supreme Court in *Brown II* decided to entrust local courts with oversight of gradual integration by local school authorities:

School authorities have the primary responsibility for elucidating, assessing, and solving these [local school] problems; courts will have to consider whether the action of school authorities constitutes good faith implementation of the governing constitutional principles. Because of their proximity to local conditions and the possible need for further hearings, the courts which originally heard these cases can best perform this judicial appraisal.<sup>88</sup>

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Desegregation of Delaware’s public schools arrived slowly, especially in the vicinity of Milford.<sup>89</sup> In 1959, Delaware began implementing a plan, approved by the federal district court, of grade-by-grade desegregation over a period of twelve years beginning with first graders. In 1960, a divided panel of the Third Circuit Court of Appeals reversed the district court, with Chief Judge Biggs adopting the logic of Chancellor Seitz’s injunction orders: “individual plaintiffs in a class suit such as those at bar, have a personal right to immediate enforcement of their claims if such be feasible. We can perceive no reason why the individual infant plaintiffs who presently actively seek integration should not be granted that right immediately.”<sup>90</sup>

On rehearing, Chief Judge Biggs distinguished rulings in other courts approving grade-by-grade integration plans. He did so on the basis that those courts were in “the deep South, a part of our Nation where emotional reactions concerning school integration are more intense than in our own State of Delaware.”<sup>91</sup> In his original opinion, Chief Judge Biggs had written: “Concededly there is still some way to go to complete an unqualified acceptance but we cannot conclude that the citizens of Delaware will create incidents of the sort which occurred in the Milford area some five years ago.”<sup>92</sup>

The model of integration ordered by the Third Circuit was that the State must process on a racially non-discriminatory basis the school assignment requests of the relatively few Black students who were “presently actively seeking

86. *Steiner*, 111 A.2d at 583-86.

87. In March 1955, in response to the publication of a negative article about Milford in a national magazine, Selwyn, *supra* note 18, the Milford City Council “declared that no Milford official had ever surrendered to mob rule since no mob was ever in evidence in the town.” Shagaloff, *supra* note 77, at 201.

88. *Brown II*, 349 U.S. at 299.

89. See, e.g., Ralph S. Holloway, *School Desegregation in Delaware*, 4 SOC. PROBS. 166, 171 (Oct. 1956) (“As indicated previously, southern Delaware schools remain segregated.... The ‘new’ [Milford] school board carries out a policy of strict segregation and has severed athletic relationships with Dover High School because Dover now permits Negro students to participate in interscholastic competition.”).

90. *Evans v. Ennis*, 281 F.2d 385, 389 (3d Cir. 1960).

91. *Id.* at 393.

92. *Id.* at 389.

integration.”<sup>93</sup> As to everyone else, much was unchanged. The sole high school in Sussex County to which all Black students had been assigned, built in 1950, remained essentially all-Black until it was dismantled in 1967, under federal Executive Branch pressure to desegregate.<sup>94</sup> It was not until 1978 that United States District Judge Murray Schwartz ordered city-suburban busing and ancillary relief “to overcome the ‘continuing conditions of inequality produced by the inherently unequal dual school system’ and vestige effects of *de jure* segregation never eradicated in Northern New Castle County.”<sup>95</sup>

### D. *Burton v. Wilmington Parking Authority*

Meanwhile, racial segregation under color of law remained intact in various aspects of public life. Local lawyer Frank Hollis, a former law clerk of Chancellor Seitz, told the story about how a class action challenging the refusal of a particular coffee shop in Wilmington to serve Black patrons in 1958 came before the Delaware Court of Chancery and later the United States Supreme Court:

The beginnings of the landmark case *Burton v. The Wilmington Parking Authority* were lodged in the efforts of seven workers at the Chrysler Newark Plant who sought to be served in a restaurant housed under lease in this government facility. When they were denied service, they were arrested and charged in the Wilmington Municipal Court with, inter alia, criminal trespass. As their legal representative, I conferred with Louis Redding, Jr., who was then counsel for the local branch of the NAACP. We decided to test the owner’s no service to blacks policy by having City Councilman Burton seek service. He was arrested for trespassing and thanks to Louis Redding and Leonard Williams, the law is now established that a governmental entity cannot by inaction do what it could not do by action - enforce and countenance discrimination on the grounds of race in a publicly-owned facility.<sup>96</sup>

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93. *Id.* at 393.

94. Education Trust, *Special Edition: Segregation, Integration and the Milford 11*, <https://edtrust.org/extraordinary-districts/special-edition-segregation-integration-and-the-milford-11/> (“It was not until 1967, when the Department of Health, Education and Welfare under President Lyndon Johnson threatened to withhold funds unless schools desegregated, that Delaware dismantled its segregated schools.”); A REPORT OF THE U.S. COMMISSION ON CIVIL RIGHTS, SOUTHERN SCHOOL DESEGREGATION 1966-67, at 1 (July 1967) (“The sanction of withdrawal of Federal Assistance has acquired increased significance with the rapid rise in such assistance under recently expanded Federal aid to education programs.”); *id.* at 8 n.18 (“Although there are no all-Negro schools in Delaware, there are schools which are nearly all-Negro. For example, in April 1967, one high school in Sussex County, Delaware had 264 Negro students and only 15 white students, all of whom were in a special class for the trainable mentally retarded.”), available at [https://www.crmvet.org/docs/ccr\\_sch\\_desegregation\\_south\\_6707.pdf](https://www.crmvet.org/docs/ccr_sch_desegregation_south_6707.pdf); Delaware Public Archives, *State of Delaware Historical Marker: William C. Jason Comprehensive High School—First African-American Secondary School in Sussex County* (“The desegregation of schools in Delaware led to the closing of Jason in June 1967 after which it became part of Delaware Technical and Community College.”), at <https://archives.delaware.gov/delaware-historical-markers/william-c-jason-comprehensive-high-school/>.

95. See *Evans v. Buchanan*, 447 F. Supp. 982, 985 (D. Del.) (quoting *Milliken v. Bradley*, 433 U.S. 267, 290 (1977)), *aff’d*, 582 F.2d 750 (3d Cir. 1978); see *id.* at 1040 (“Over twenty-three years have elapsed since *Brown II* and the goal of nondiscriminatory public education in the desegregation area has not reached fruition.”).

96. Frank Hollis, *My Memories of Law Practice in Wilmington, Delaware*, 16 DEL. LAW. No. 2, at 26-27 (Summer 1998), available at <https://www.delawarebarfoundation.org/all-documents/delaware-lawyer-magazine/1998-volume-16/60-volume16-number2-summer1998/file>.



In 1958, no State or federal statutes forbade private restaurants from discriminating on the basis of race. Nor were all eating establishments in downtown Wilmington integrated by custom.<sup>97</sup> In its defense, The Eagle Coffee Shoppe invoked a Delaware statute that read as follows:

No keeper of an inn, tavern, hotel, or restaurant, or other place of public entertainment or refreshment of travelers, guests, or customers shall be obliged, by law, to furnish entertainment or refreshment to persons whose reception or entertainment by him would be offensive to the major part of his customers, and would injure his business.<sup>98</sup>

The basis for the plaintiff's claim was the Equal Protection Clause of the Fourteenth Amendment and the application of *Brown I*. Plaintiff argued that the Eagle Coffee Shoppe was bound by the Fourteenth Amendment because it leased space from the Wilmington Parking Authority, as part of a parking lot structure on Ninth Street. The parking authority disclaimed any control over the policies and practices of the coffee shop. The 20-year lease, signed in April 1957, only required the tenant to "use the leased premises in accordance with all applicable laws, statutes, ordinances and rules and regulations of any federal, state or municipal authority."<sup>99</sup>

Vice Chancellor Marvel reasoned that Wilmington Parking Authority was prohibited from leasing space in a public parking facility to a commercial tenant that discriminated on the basis of race:

There is no doubt but that the Parking Authority is a tax exempt agency of the State engaged in furnishing public parking service in a facility, the financing of which is being borne in large part by rentals received from tenants occupying other parts of the building. Because these rentals constitute a substantial and integral part of the means devised to finance a vital public facility, in my opinion it was incumbent on the Authority to negotiate and enter into leases such as the one here involved on terms which would require the tenant to carry out the Authority's constitutional duty not to deny to Delawareans the equal protection of the laws. To say that the Authority has no statutory power to operate the restaurant itself is to beg the question in view of the direct relation of rental income to the financing of the facility.<sup>100</sup>

Vice Chancellor Marvel decided that the plaintiff was entitled to a declaratory judgment preventing the coffee shop from declining to serve him and others on the basis of their race.

One way to think about this reasoning and outcome is that Vice Chancellor Marvel interpreted *Brown I* as creating an equitable entitlement of Black citizens to enforce as third-party beneficiaries a non-discrimination covenant absent in the lease that the State of Delaware had been obliged to insist upon. The Vice Chancellor's declaratory judgment and injunction enforced the Plaintiff's equitable right to the obligatory covenant.

The Delaware Supreme Court reversed, reasoning that the parking authority's interest in collecting rent was not sufficient to change the private character of the coffee shop. The Delaware Supreme Court distinguished cases involving a public park, a public airport, a courthouse cafeteria, a municipal swimming pool, and a public amphitheater, on the basis

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97. See Shagaloff, *supra* note 80, at 221 ("In the Wilmington area, nonsegregation policies have been adopted since 1950 by the two leading hotels, downtown movies, the legitimate theatre, and a few eating places in suburban areas.").

98. 24 DEL. C. § 1501, *quoted in* *Burton v. Wilmington Parking Authority*, 365 U.S. 715, 717 n.1 (1961).

99. 150 A.2d 197, 199 (Del. Ch. 1959), *rev'd*, 157 A.2d 894 (Del. 1960), *rev'd*, 365 U.S. 715 (1961).

100. *Id.* (citation omitted).

that a relatively small percentage of the overall cost of the Wilmington Parking Authority structure, its allocation of space, and its revenue was attributable to commercial leases, as opposed to public parking.<sup>101</sup>

In reaching that decision, the Delaware Supreme Court stated that it refused to extend *Brown I* and encroach further on Delaware law, which historically tolerated both public and private race discrimination:

We neither condemn nor approve such private discriminatory practices for the courts are not the keepers of the morals of the public. We apply the law, whether or not that law follows the current fashion of social philosophy.

Particularly is this true of a state court which is called upon in this field to apply rules made for us by the Supreme Court of the United States, which, in the case of this state, have resulted in the discard of a large portion of our local law dealing with the emotional subject of racial relations. We are, of course, bound to follow the Federal decisions, but we think we are equally bound, when they erode our local law, not to extend them to a point which they have not as yet gone.<sup>102</sup>

The Delaware Supreme Court concluded by invoking the above-quoted Delaware statute, 24 *Del. C.* § 1501. The Court stated that because the coffee shop was “acting in a purely private capacity,” consistent with the common and the statutory law of Delaware, it was “not required to serve any and all persons entering its place of business, any more than the operator of a bookstore, barber shop, or other retail business is required to sell its product to every one.”<sup>103</sup> The plaintiff argued that under Delaware common law, an inn or tavern could not deny service to any customer, but the Delaware Supreme Court decided that even though the coffee shop served alcoholic beverages, it was “primarily a restaurant” and protected by the Delaware statute.

The case proceeded to the United States Supreme Court, in part on the question whether the Delaware Supreme Court had construed 24 *Del. C.* § 1501 in a manner incompatible with the Fourteenth Amendment. A separate question was whether the discriminatory actions of the coffee shop were “purely private” or subject to the Fourteenth Amendment and *Brown I*.

Five members of the United States Supreme Court expressly endorsed the reasoning of Vice Chancellor Marvel respecting the responsibility of the State of Delaware as a commercial landlord, and rejected the holding of the Delaware Supreme Court:

It is irony amounting to grave injustice that in one part of a single building, erected and maintained with public funds by an agency of the State to serve a public purpose, all persons have equal rights, while in another portion, also serving the public, a Negro is a second-class citizen, offensive because of his race, without rights and unentitled to service, but at the same time fully enjoys equal access to nearby restaurants in wholly privately owned buildings. *As the Chancellor pointed out, in its lease with Eagle the Authority could have affirmatively required Eagle to discharge the responsibilities under the Fourteenth Amendment imposed upon the private enterprise as a consequence of state participation.* But no State may effectively abdicate its responsibilities by either ignoring them or by merely failing to discharge them whatever the motive may be.... The State has so far insinuated itself into a position of interdependence with Eagle that it must be recognized as a joint participant in the challenged activity, which, on that account, cannot be considered

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101. *Wilmington Parking Auth.*, 157 A.2d at 896-902.

102. *Id.* at 901-02.

103. *Id.* at 902.

to have been so ‘purely private’ as to fall without the scope of the Fourteenth Amendment.

... Specifically defining the limits of our inquiry, *what we hold today is that when a State leases public property in the manner and for the purpose shown to have been the case here, the proscriptions of the Fourteenth Amendment must be complied with by the lessee as certainly as though they were binding covenants written into the agreement itself.*<sup>104</sup>

Justice Stewart concurred on the alternative basis that the Delaware Supreme Court had unconstitutionally construed a State statute “as authorizing discriminatory classification based exclusively on color. Such a law seems to me clearly violative of the Fourteenth Amendment.”<sup>105</sup> Three other Justices would have remanded the case to the Delaware Supreme Court “for clarification as to the precise basis of its decision.”<sup>106</sup> These three Justices agreed that it would be impermissible to construe the state statute as authorizing racial discrimination, and that the constitutional question of what constitutes impermissible state action under *Brown I* could be avoided if the statutory interpretation question controlled. No United States Supreme Court Justice shared the Delaware Supreme Court’s apparent sympathy for pre-*Brown I* state and federal law.

## II. CONCLUSION

There is an element of myth-making or at least misunderstanding about the relationship between the rulings of the Delaware Courts in *Belton/Bulah* and the rulings by the United States Supreme Court in *Brown v. Board of Education*. The historical marker in front of the Leonard L. Williams Justice Center in Wilmington states, somewhat inaccurately:

Redding argued that laws requiring schools to be segregated by race denied the African-American students their constitutional right to the equal protection of the law. The chief judge of the Court of Chancery, Collins J. Seitz, agreed, finding that segregation was inherently harmful to the students, and therefore unconstitutional.... On May 17, 1954, the Supreme Court adopted the reasoning of Redding and Seitz in a decision that effectively ended the segregation of public schools throughout the nation.<sup>107</sup>

One of the aims of this article is to provide clarity about what Chancellor Seitz and the Delaware Court of Chancery did in the course of a long struggle against racial segregation.

In the decade between 1950 and 1959, Vice Chancellor/Chancellor Seitz and Vice Chancellor Marvel adjudicated four constitutional challenges to legally entrenched racial segregation. The first two cases were decided under *Plessy v. Ferguson*. The latter two cases were decided under *Brown I*. The disposition of the four cases was consistent with each other and distinctive for their time.

All four cases were decided in favor of the plaintiffs. The two members of the Court of Chancery both held that the Equal Protection Clause created an enforceable right to equal treatment and equal opportunities by the State of Delaware and its instrumentalities.

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104. *Burton*, 365 U.S. at 724-26 (emphasis added).

105. *Id.* at 727 (Stewart, J., concurring).

106. *Id.* at 729 (Harlan, J., dissenting); *see id.* at 731 (Frankfurter, J. dissenting).

107. Delaware Public Archives, *State of Delaware Historical Marker: Brown v. Board of Education*, at <https://archives.delaware.gov/delaware-historical-markers/brown-v-board-education/>.

As notably, the Court of Chancery awarded immediate equitable remedies on behalf of the named plaintiffs and similarly situated members of a socially marginalized race, in a manner that would unsettle local government and local folkways. Black high school students and college students became entitled to apply to the University of Delaware and have their applicants considered in a non-discriminatory manner; Black students became entitled to attend Claymont High School and Hockessin School No. 29; the Milford Eleven were ordered to be re-enrolled in Milford High School; City Councilman Burton and the Black workers at the Newark Chrysler plant became entitled to dine at the Eagle Coffee Shoppe. The proffered alternative of structural injunctions, such as increased funding for Delaware State University or Howard High School, or a future gradual integration plan for public schools in Sussex County, were rejected. The equitable rights of the plaintiffs were not balanced against opposing public sentiment, or even the threat of violence.

The discrete injunctions awarded by the Court of Chancery on behalf of the name plaintiffs can be seen as examples of traditional equitable relief, consistent with the larger private law docket of the Court. The injunctions are akin to awarding specific performance against a defaulting seller, or imposing a constructive trust upon the proceeds taken by a disloyal fiduciary. They put the plaintiffs in the position to which they were equitably entitled.

Discrete, immediate injunctive relief may not have been a scalable or sufficient means of redress for systemic violations of constitutional rights. But at the time, the relief awarded to the plaintiffs by the Court of Chancery compared favorably to stasis. In December 1956, the then-leading scholar of equity, Professor Zechariah Chafee, Jr. of Harvard Law School, wrote a private memo to the members of the United States Supreme Court entitled “The Disintegration of Integration,” in which he voiced his frustration with *Brown II*:

I have great dissatisfaction with the present situation as to segregation. Once the Supreme Court had laid down the general principle of integration in the first case, I think that everything depended on the framing of a satisfactory scheme to carry out that principle.... Instead of framing a scheme, [the Supreme Court] turned all the dirty work over to local United States courts....

I don't believe that a problem which involved every school in a dozen states which are firmly determined not to do anything towards integration, can be solved by fragmentary litigation.<sup>108</sup>

*Parker*, *Belton/Bulah*, *Simmons*, and *Burton* show what could be achieved through fragmentary litigation adjudicated by local trial courts. The manner by which two members of the Court of Chancery discharged their judicial oath in these four cases is worthy of study and honor several decades later.

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108. Zechariah Chafee memo to U.S. Supreme Court, “The Disintegration of Integration” (Dec. 19, 1956), Zechariah Chafee Papers, box 86, folder 1, Harvard Law School Library (on file with the author).





## DELAWARE'S "CONTROL GROUP" JURISPRUDENCE: A SURVEY OF RECENT DECISIONS

Nicholas D. Mozal, Justin T. Hymes, and Faith C. Flugence\*

*This article describes the development of Delaware's control group jurisprudence in recent years. Whether stockholders are members of a "control group" under Delaware law has consequences. The fiduciary duties that run with controlling stockholder status impact the viability of pleadings stage motions by potentially heightening the applicable standard of review and dictating which defenses are available to defendants. The article examines the Delaware Supreme Court decisions that have prompted stockholder plaintiffs to focus on pleading the existence of a controller or control group. That increased focus by stockholder plaintiffs has led to the Delaware courts issuing at least ten rulings addressing whether a group of stockholders constituted a "control group" since 2017. We explain that this series of recent rulings reflects only the most recent example of Delaware's commitment to a common law process that refines its corporate law iteratively and quickly. That process, and the resulting body of case law, now guides future transactional planning and also provides predictable results in future litigation.*

Since 2017, the Delaware Supreme Court and the Delaware Court of Chancery have together issued at least ten rulings analyzing whether a group of stockholders constituted a "control group" for purposes of Delaware law. This Article surveys those decisions, explains how broader developments in Delaware corporate law brought the control group issue to the forefront, and addresses how the resulting opinions reflect the Delaware judiciary's ability to build a critical mass of guidance for transactional attorneys seeking insight into a particular topic.

The short story is that the Delaware Supreme Court issued decisions in *Gentile v. Rossette*<sup>1</sup> and *Corwin v. KKR Financial Holdings*<sup>2</sup> that led stockholder plaintiffs to challenge transactions with controlling stockholders as a means of avoiding the business judgment rule. Attempts to lump together multiple stockholders as a control group followed. The cases led to the Court of Chancery and the Delaware Supreme Court issuing lengthy opinions addressing these issues. Now, just five years later, a "cohesive body of law" exists to guide parties.<sup>3</sup> As discussed below, the best way to understand the post-*Corwin*<sup>4</sup> decisions is to perceive a "spectrum" of results that can be classified based on recurring factors.

The Article proceeds as follows.<sup>5</sup> Part I explains how *Gentile* and *Corwin* prompted stockholder plaintiffs to focus on controllers generally. Part II surveys the post-*Corwin* control group decisions. Part III discusses takeaways from the decisions. Part IV explains how together the decisions reflect the vigor of Delaware's common law.

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1. 906 A.2d 91 (Del. 2006).

2. 125 A.3d 304 (Del. 2015).

3. See Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L. REV. 473, 474 (2013).

4. 125 A.3d 304 (Del. 2015).

5. This Article focuses on Delaware law and so it does not delve into the definition of "control group" under federal securities laws or regulations unless addressed in the Delaware opinions.

## I. THE GROWING IMPORTANCE OF CONTROLLING STOCKHOLDERS

When a stockholder or group of stockholders gains control is “an age-old issue.”<sup>6</sup> The task of “[a]rticulating standards to identify the presence of such a group has bedeviled courts for nearly a century.”<sup>7</sup>

Two Delaware Supreme Court decisions brought the issue to the forefront. The first was the 2006 decision in *Gentile*, which granted stockholders post-merger standing to pursue dilution claims in limited circumstances.<sup>8</sup> A dilution claim is traditionally a derivative claim, and a merger extinguishes standing to assert it.<sup>9</sup> Under *Gentile*, a *claim* could be “both derivative and direct” if:

(1) a stockholder having majority or effective control causes the corporation to issue “excessive” shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders.<sup>10</sup>

A key component of this formulation is the presence of a controlling stockholder. *Gentile* precipitated a series of decisions about what constituted a control group.<sup>11</sup> One of those cases introduced the “legally significant connection” test, discussed below. That decision was a 2009 opinion in *Dubroff v. Wren Holdings* where Vice Chancellor Noble wrote:

Although a controlling shareholder is often a single entity or actor, Delaware case law has recognized that a number of shareholders, each of whom individually cannot exert control over the corporation (either through majority ownership or significant voting power coupled with formidable managerial power), can collectively form a control group where those shareholders are connected in some legally significant way—e.g., by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal.<sup>12</sup>

Because a plaintiff could preserve post-merger standing to assert a dilution claim if a controlling stockholder was involved, parties joined issue over the “legally significant connection test.”

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6. See Ann M. Lipton, *After Corwin: Down the Controlling Shareholder Rabbit Hole*, 72 VAND. L. REV. 1977, 1997–98 (2019). There are also federal securities law and stock exchange listing requirements that address the issue, which are beyond the scope of this article.

7. *Id.*

8. 906 A.2d 91 (Del. 2006).

9. See generally *Brookfield Asset Mgmt., Inc. v. Rosson*, 261 A.3d 1251, 1262 (Del. 2021) (discussing continuous ownership requirement).

10. *Gentile*, 906 A.2d at 100.

11. Compare *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 659 (Del. Ch. 2013) (holding control group was adequately pled as part of analyzing a *Gentile* claim) and *In re Nine Sys. Corp. S’holders Litig.*, 2013 WL 771897, at \*6 (Del. Ch. Feb. 28, 2013) (ruling at summary judgment that the Court could not conclude as a matter of undisputed fact that there was no control group as part of *Gentile* analysis) with *DiRienzo v. Lichtenstein*, 2013 WL 5503034, at \*25 (Del. Ch. Sept. 30, 2013) (holding control group was not adequately pled as part of analyzing a *Gentile* claim).

12. 2009 WL 1478697, at \*3 (Del. Ch. May 22, 2009).



The second Delaware Supreme Court decision to spur control group jurisprudence was the 2015 ruling in *Corwin v. KKR Financial Holdings*.<sup>13</sup> There, the Delaware Supreme Court concluded "when a transaction not subject to the entire fairness standard is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies."<sup>14</sup> Subsequent decisions interpreted the "not subject to the entire fairness language" of *Corwin* to mean *Corwin* applies "absent a looming conflicted controller."<sup>15</sup> In practice *Corwin* "widened the gulf between [review of] transactions that involve a controlling shareholder and those that do not."<sup>16</sup> For plaintiffs, identifying a conflicted controlling stockholder became key to avoiding *Corwin*.

After *Corwin*, the arguments on motions to dismiss fell into a pattern:

In the realm of Delaware post-closing shareholder litigation, over the past seven years, a rhythm has emerged in the assertion of claims and defenses as our courts have clarified and refined the application of standards for reviewing fiduciary conduct. *In hopes of securing more rigorous judicial scrutiny of fiduciary conduct, stockholders invoke the sounds of minority blockholders who act as if they are controlling stockholders*, fiduciary decisionmakers who are overcome by allegiances to the controller, and stockholders who are coerced to sell their shares while starved of accurate and complete information. *In hopes of securing more judicial deference to fiduciary decision making, defendants invoke the sounds of passive minority blockholders* and presumptively disinterested, independent (and often exculpated) fiduciaries who have faithfully served fully informed, uncoerced stockholders.<sup>17</sup> *Gentile* and *Corwin* thus set the rhythm that cases danced to, leading to rulings on the control group issue.

While these judicial developments were taking place, dynamic market changes created more parties who arguably were controllers or part of a control group. "Due to a confluence of factors, including an unprecedented influx of available private capital, startups are staying private longer on average and raising larger late-stage funding rounds from [a] greater diversity of investors" that includes "mutual funds, pension funds, hedge funds, corporate investors, and sovereign wealth funds."<sup>18</sup> These "investors are often granted individualized rights, such as designated board seats and the ability to block various corporate actions," meaning "corporate control rights are increasingly allocated in unique and idiosyncratic ways" across increasingly complex share structures involving multiple classes.<sup>19</sup> The same became true for public companies, where dual-class stock and other techniques enabled the consolidation of control rights.

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13. 125 A.3d 304 (Del. 2015).

14. *Id.* at 309.

15. *Larkin v. Shah*, 2016 WL 4485447, at \*13 (Del. Ch. Aug. 25, 2016).

16. *Lipton*, *supra* note 6, at 1979.

17. *In re GGP, Inc. S'holder Litig.*, 2021 WL 2102326 (Del. Ch. May 25, 2021) (emphasis added); *see also* Note, *Controller Confusion: Realigning Controlling Stockholders and Controlled Boards*, 133 HARV. L. REV. 1706, 1712 (2020) (stating "controlling stockholder status remains significant, both for the individual in acquiring fiduciary duties and for the board that may find its decisions subject to heightened scrutiny and difficult to cleanse").

18. Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 175 (2019).

19. Ann M. Lipton, *The Three Faces of Control*, 77 BUS. LAW. 801, 803 (2022); *see also* Pollman, *supra* note 18, at 175 (discussing increasing complexity of startup governance and capital structures).

Thus, the controller designation under Delaware law took “on a new legal significance at the precise moment when business realities have made the exercise of control more difficult to ascertain.”<sup>20</sup> The confluence of these events led to a flurry of decisions.

## II. *POST-CORWIN* CONTROL GROUP DECISIONS

The Court of Chancery and the Delaware Supreme Court have issued a series of decisions on controllers and control groups. This section discusses those cases as a predicate for identifying common characteristics.

### A. *Van der Fluit v. Yates*<sup>21</sup>

This *Van der Fluit* decision provides a blueprint for post-*Corwin* control group arguments. The plaintiffs argued *Corwin* did not apply to Oracle’s acquisition of Opower, Inc., because of the existence of a control group.<sup>22</sup> The Court of Chancery decided that there was no control group, but that *Corwin* still did not apply because of disclosure violations.<sup>23</sup> Despite clearing the *Corwin* hurdle, the plaintiff failed to allege non-exculpated breaches of fiduciary duty, resulting in the dismissal of the complaint.

#### 1. Background

Opower was founded by Yates and Laskey. At the time of the merger, Yates was the company’s CEO, board chairman, and owned 22.4% of its outstanding stock, largely through preferred shares. Laskey was the company’s president, a member of its board, and owned 17.4% of the company’s outstanding stock, again largely through preferred shares. New Enterprise Associates (“NEA”) was a venture capital fund that held 21.8% of the company’s outstanding stock, and had a director designee on the company’s board. MHS Capital was an early seed investor that held an 8.3% ownership stake.<sup>24</sup> Yates, Laskey, NEA, and MHS were parties to an Investor Rights Agreement that gave “registration and informational rights to early stage investors” that held preferred stock.

For roughly two years, Oracle flirted with purchasing Opower, finally making a firm offer to purchase Opower for \$9-\$10 per share. Opower ran a sale process, hired an investment banker to seek other bids, and negotiated with Oracle for a higher offer. No other bidders emerged, and Opower accepted an offer from Oracle at \$10.30 per share. When finalizing the deal, the company’s largest investors entered into side agreements. Numerous stockholders, including Yates, Laskey, and NEA, entered into tender and support agreements that committed them to the transaction. Yates, Laskey and other members of management negotiated for the right to convert their unvested Opower options into comparable unvested Oracle options.<sup>25</sup>

#### 2. Analysis

After the stockholders filed suit, the defendants moved to dismiss the complaint. The parties’ briefing focused on the relevant standard of review. The plaintiffs advanced multiple arguments as to why the business judgment rule did

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20. Lipton, *supra* note 6, at 1990.

21. 2017 WL 5953514 (Del. Ch. Nov. 30, 2017).

22. *Id.* at \*6; *see Corwin*, 125 A.3d 304 (Del. 2015).

23. *Yates*, 2017 WL 5953514, at \*1.

24. *Id.* at \*1–\*2.

25. *Id.* at \*3.

not apply. The court addressed three primary issues: whether there was a controlling stockholder, whether informed and uncoerced stockholders approved the transaction, and whether the stockholders adequately pled non-exculpated claims for breach of fiduciary duty.<sup>26</sup>

The plaintiff argued that Yates, Laskey, NEA, and MHS were a control group based on their combined stock holdings, which gave them approximately 70% of the company's voting power, their connections through the Investor Rights Agreement (which pre-dated the IPO), and their entry into the tender and support agreements, which MHS did not sign. Quoting Chancery precedent, the court observed that "[s]tockholders can collectively form a control group where those shareholders are connected in some legally significant way—e.g. by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal."<sup>27</sup> "The law does not require a formal written agreement, but there must be some indication of an actual agreement. Plaintiffs must allege more than mere concurrence of self-interest among certain stockholders to state a claim based on the existence of a control group."<sup>28</sup>

The court concluded NEA and MHS were not members of a control group based on the Investor Rights Agreement, which "contain[ed] no voting, decision-making, or other agreements that bear on the transaction challenged in the instant case."<sup>29</sup> The tender and support agreements also were not sufficient, as they only reflected a "concurrence of self-interest among certain stockholders."<sup>30</sup> Many stockholders signed tender and support agreements, and the plaintiffs "offer[ed] no explanation for why NEA and MHS are members of an alleged control group while the numerous other signatories to these agreements [were] not."<sup>31</sup> The plaintiffs noted that NEA had a director designee, but the plaintiffs failed to explain why that fact mattered.

The plaintiffs did not plead "meaningful connections" or "managerial control" between Yates and Laskey, because the complaint failed to plead any facts about their personal relationships, working relationships, a history of voting together, or instances where they together dominated the board or the operations of the company. It was not enough that they held approximately 30% of the company's voting power, were parties to the Investor Rights Agreement and tender and support agreements, rolled-over their options, and accepted jobs with Oracle post-closing. The court distinguished *Frank v. Elgamal*, because in that case, four individuals held 71.19% of the outstanding voting power, compared to Yates and Laskey's holdings of less than 30%.<sup>32</sup> The complaint also lacked specific allegations of managerial control, such as the presence of subordinates or family members on the board or in the management of the company suggesting "day-to-day managerial supremacy."<sup>33</sup>

### 3. Key Takeaway

*Yates* was one of the earliest post-*Corwin* decisions to consider control group allegations. The decision built upon the existing precedent to avoid a rule that would lump together all early, venture, and management investors. It refined

26. Technically the deal was a tender offer structured under 8 *Del. C.* § 251(h). The Court noted that it had already decided the question of whether *Corwin* applied to such a structure involving tendering of shares in a tender offer, rather than voting shares in favor of a merger. *Id.* at \*5 (citing *In re Volcano Corp. S'holder Litig.*, 143 A.3d 727, 747 (Del. Ch. 2016), *aff'd*, 156 A.3d 697 (Del. 2017) (TABLE)).

27. *Id.* (quoting *Frank v. Elgamal*, 2012 WL 1096090, at \*8 (Del. Ch. Mar. 30, 2012)).

28. *Id.* (quoting *In re Crimson Expl. Inc. S'holder Litig.*, 2014 WL 5449419, at \*15 (Del. Ch. Oct. 24, 2014)).

29. *Id.* at \*6.

30. *Id.* (quoting *In re Crimson Expl. Inc. S'holder Litig.*, 2014 WL 5449419, at \*15).

31. *Id.* at \*6.

32. *See* 2012 WL 1096090, at \*4 (Del. Ch. Mar. 30, 2012).

33. *Yates*, 2017 WL 5953514, at \*7 (quoting *In re Cysive Inc. S'holders Litig.*, 836 A.2d 531, 552 (Del. Ch. 2003)).

the focus on pre-existing stockholder agreements to consider whether the agreements conferred voting or decision-making authority on specific investors in the challenged transaction, rather than on issues generally. In taking these steps, the decision provided the cornerstone for future control group rulings.

### B. *In re Hansen Medical, Inc. Stockholders Litigation*<sup>34</sup>

The author of *Yates*, then Vice Chancellor Montgomery-Reeves, addressed the control group question again only months later in *Hansen*. In fact, the court noted in a footnote it issued *Yates* after briefing on the motion to dismiss in *Hansen* had concluded.<sup>35</sup> Foreshadowing the back and forth between the two decisions, the Vice Chancellor *sua sponte* distinguished *Yates* in concluding that the *Hansen* plaintiffs had pled enough facts to support an inference of a control group between two investors who owned 65% of the company's equity and had a "history of coordination" that impacted the deal.<sup>36</sup>

#### 1. Background

The plaintiffs in *Hansen* challenged a squeeze-out merger. Hansen had struggled to avoid defaulting on its debt.<sup>37</sup> The acquirer identified certain "Key Stockholders" that it wanted to negotiate with directly to ensure their support for the merger.<sup>38</sup> The result of that demand was for the acquirer and the Key Stockholders to enter into "agreements that allowed the Key Stockholders, but only the Key Stockholders, to negotiate directly with" the acquirer.<sup>39</sup> Through those negotiations, the Key Stockholders received the ability to roll over their shares into stock of the acquirer—an option not provided to other stockholders—and agreed to vote for the merger.<sup>40</sup>

#### 2. Analysis

To show that two of the Key Stockholders constituted a control group, the plaintiff cited their extensive historical ties and their large stockholdings, which comprised 65% of the equity. The court noted that those stockholders "acted in concert when dealing with their Hansen holdings," including through their initial participation in a private placement, their later participation in two additional private placements, and their outsized influence over those private placements.<sup>41</sup> Looking beyond Hansen, the two had a twenty-one year history of "coordinating their investment strategy in at least seven different companies," and had designated themselves as a "group" in SEC filings related to a different company.<sup>42</sup>

The court explained how those factors resulted in the stockholders being connected in a legally significant way:

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34. 2018 WL 3025525 (Del. Ch. June 18, 2018).

35. *Id.* at \*6 n.79.

36. *Id.* at \*7–8.

37. *Id.* at \*2–3.

38. *Id.* at \*3.

39. *Id.* at \*7.

40. *Id.* at \*4.

41. *Id.* at \*2.

42. *Id.* at \*7.

Although each of these factors alone, or perhaps even less than all these factors together, would be insufficient to allege a control group existed, all of these factors, when viewed together in light of the Controller Defendants' twenty-one year coordinated investing history, make it reasonably conceivable that the Controller Defendants functioned as a control group during the Merger.

....

Defendants offer reasonable explanations for some of the connections, parallel investments, and actions of the purported control group. One might even argue that they offer a more compelling version of events. It may well be that Defendants' version prevails at a later stage of litigation. At the motion to dismiss stage, however, the question is not whether Plaintiffs offer the only, or even the most, reasonably conceivable version of events. Rather, the question is whether Plaintiffs have stated a reasonably conceivable claim for which relief can be granted."<sup>43</sup>

The court therefore denied the defendants' motion.

### 3. Key takeaway

The key distinction that separated *Hansen* from *Yates* was the clear coordination by the investors and their history of investing together in other companies. Based on that factor, *Hansen* and *Yates* stand at on opposite sides of the spectrum, with each providing an example of what allegations do or do not plead a control group. As we will see, that is how both litigants and the courts have used the decisions going forward.

#### C. *Carr v. New Enterprise Associates, Inc.*<sup>44</sup>

In *Carr v. New Enterprise Associates, Inc.*, the Delaware Court of Chancery partially dismissed claims for breach of fiduciary duty brought by stockholders of Advanced Cardiac Therapeutics, Inc. ("ACT").<sup>45</sup> The lead plaintiff was a co-founder of ACT who alleged that New Enterprise Associates, Inc. ("NEA") was ACT's controlling shareholder and had breached its fiduciary duties orchestrating a self-interested transaction. The court held that the complaint had not adequately alleged the existence of controller.

### 1. Background

NEA invested in ACT in 2014 by purchasing preferred stock. NEA also entered into a voting agreement with ACT. The plaintiff alleged that soon after the investment, NEA began making changes in ACT. The plaintiff also alleged that NEA engineered the issuance of additional shares of preferred stock to increase its control of the company. The changes NEA made included appointing a new CEO, removing two directors, and filling one of the seats.<sup>46</sup> The key issuance of preferred stock occurred in April 2014, when NEA and other select investors acquired Series A-2 preferred shares, resulting in NEA owning more than 65% of ACT's shares on an as converted basis.<sup>47</sup> The plaintiff was not invited

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43. *Id.* at \*7–8.

44. 2018 WL 1472336 (Del. Ch. Mar. 26, 2018).

45. *Id.* at \*1.

46. *Id.* at \*3.

47. *Id.*

to participate. The consent approving the transaction acknowledged that four of the six directors had a material financial interest in the deal.<sup>48</sup>

The Series A-2 issuance valued ACT at approximately \$15 million.<sup>49</sup> Six months later, ACT sold a warrant to Abbott Laboratories (“Abbott”) for \$25 million that gave Abbott the option to purchase all of ACT’s equity for up to \$185 million.<sup>50</sup> The Warrant Transaction was conditioned on Abbott acquiring another company, Topera, where NEA and Abbott were the principal investors.<sup>51</sup> Meanwhile, another bidder offered to acquire ACT for up to \$300 million.<sup>52</sup> In October 2016, ACT repurchased the warrant from Abbott for \$25 million in cash.<sup>53</sup> On these facts, the plaintiff alleged that NEA became ACT’s controlling stockholder and then breached its fiduciary duties by orchestrating the potential sale of ACT to Abbott for an undervalued price.<sup>54</sup>

## 2. Analysis

The court dismissed the claim against NEA based on its status as a controlling stockholder for purposes of the Series A-2 transaction.<sup>55</sup> Ultimately, the court determined that plaintiff did not adequately plead that there was a control group at the time of the Series A-2 financing given that nothing in the voting agreement between NEA and other stockholders constituted a “pact” to work together.<sup>56</sup> The court concluded that the voting agreement only addressed the election of two of seven directors and did not result in NEA having control of the board. Because the allegations about NEA’s status as a controller failed, the court dismissed the claims against NEA.

## 3. Key takeaway

*Carr* builds on *Yates* by focusing on the nature of the agreement. Under the court’s analysis, an agreement addressing a different topic (the appointment of two of seven board seats) did not bind the parties in a legally significant way for a different transaction, such as the merger.<sup>57</sup> Adequately pleading a control group allegation requires additional facts showing a plan by the parties to advance common goals or interests.

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48. *Id.* at \*4.

49. *Id.* at \*3.

50. *Id.* at \*1.

51. *Id.* at \*1–2, \*5.

52. *Id.*

53. *Id.* at \*6.

54. *Id.* at \*1.

55. *Id.* at \*9–10.

56. *Id.* at \*10.

57. 2018 WL 1472336, at \*10 (Del. Ch. Mar. 26, 2018).

### D. *Sheldon v. Pinto Technology Ventures, L.P.*<sup>58</sup>

The Delaware Supreme Court weighed in on control group jurisprudence in *Sheldon v. Pinto Technology Ventures, L.P.* The Court of Chancery dismissed the plaintiffs' breach of fiduciary duty claims, concluding the plaintiff failed to plead the existence of a control group. The Delaware Supreme Court affirmed and, in doing so, provided the first in depth analysis from the state's high court on what constitutes a control group.

#### 1. Background

Through various rounds of financings, including a recapitalizing transaction, three venture capital firms (the "VCs") acquired approximately 60% of the outstanding shares of IDEV Technologies, Inc. ("IDEV").<sup>59</sup> After electing not to participate in the recapitalization, certain founders and stockholders were diluted from over 3.7% ownership to less than 0.1%.<sup>60</sup> Ultimately, IDEV was acquired for \$310 million, leaving the plaintiffs with approximately \$22,500 in merger proceeds, compared to more than \$11.6 million that they would have received before the recapitalization.<sup>61</sup> The plaintiffs claimed they had standing to assert a *Gentile* claim post-closing because the VCs had acted together as a control group.<sup>62</sup> To support their claim, they alleged that the VCs (1) collectively owned more than 60% of the company's outstanding shares, (2) could each nominate a director to the board under a stockholders agreement, (3) had a coordinated history of co-investing, and (4) acted together to force through the recapitalization.<sup>63</sup> The plaintiffs analogized the facts to those present in *Hansen*.<sup>64</sup>

#### 2. Analysis

The Court of Chancery dismissed the complaint, concluding there was no control group. The court compared the allegations to those in *Yates* and *Hansen* and concluded that they fell "short of those in *Hansen*, and were more akin to those in *van der Fluit v. Yates*."<sup>65</sup> After a detailed discussion of those decisions, the court explained that the VCs "in this case were not as intertwined, collaborative, or exclusive as the members of the *Hansen* control group."<sup>66</sup> That was because the plaintiffs failed to allege the same connections as those in *Hansen*, instead "merely indicat[ing] that venture capital firms in the same sector crossed paths in a few investments" which was "different from the 'long history of cooperation and coordination' in *Hansen*."<sup>67</sup>

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58. 2019 WL 336985 (Del. Ch. Jan. 25, 2019), *aff'd*, 220 A.3d 245 (Del. 2019).

59. *Id.* at \*2–4.

60. *Id.* at \*2.

61. *Id.* at \*4.

62. *Id.* at \*7 (citing *Gentile*, 906 A.2d 91 (Del. 2006)).

63. *Id.* at \*7–8.

64. *Id.*

65. *Id.* at \*9.

66. *Id.*

67. *Id.*

It was also important to the court that the VCs “were not the only participants” in the various IDEV financing rounds, and there was no agreement requiring any stockholders to vote in favor of the challenged transactions.<sup>68</sup> The plaintiffs lacked a response to the fact that “[o]ther investors participated in those rounds and received the same securities, but [were] not alleged to be part of the control group.”<sup>69</sup> In sum, to the vice chancellor, the “case more closely resembles *van der Fluit* than *Hansen*,” and so warranted the same result.<sup>70</sup>

The court also noted that plaintiffs were wrong to “seek a charitable reading of their allegations based on *Hansen*’s explanation that determining ‘whether a control group exists is fact intensive’ and ‘particularly difficult to ascertain at the motion to dismiss stage.’”<sup>71</sup> Instead, *van der Fluit* made “clear the Court can decide the issue at the motion to dismiss stage, and a plaintiff must still plead facts that make the conclusion reasonably conceivable.”<sup>72</sup>

### 3. Supreme Court decision

On appeal, the Supreme Court analyzed the prior Chancery cases addressing control groups and adopted the legally significant connection standard articulated in numerous Chancery decisions:

To demonstrate that a group of stockholders exercises control collectively, the [plaintiff] must establish that they are connected in some legally significant way—such as by contract, common ownership, agreement, or other arrangement—to work together toward a shared goal. To show a legally significant connection, the [plaintiff] must allege that there was more than a mere concurrence of self-interest among certain stockholders. Rather, there must be some indication of an actual agreement, although it need not be formal or written.<sup>73</sup>

The Supreme Court described *van der Fluit* and *Hansen* as “two cases on opposite ends of the spectrum,” and compared the facts before it to those two decisions.<sup>74</sup> The court agreed with the Vice Chancellor that (1) the ability of the VCs to appoint directors did not, without more, establish domination or control; (2) the plaintiffs had not pled that the VCs had a “long and close relationship” when the complaint only named four companies in which two or more of the VCs had co-invested and no instances where all three VCs participated; and (3) the stockholders agreement that bound *all* of the company’s stockholders was unrelated to the merger and did not dictate action in connection with the deal. Because the complaint failed to show that the VCs had more than a “mere concurrence of self-interest,” the Supreme Court concluded the Court of Chancery had correctly dismissed the complaint for failure to state a claim.<sup>75</sup>

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68. *Id.*

69. *Id.*

70. *Id.* at \*10.

71. *Id.* at \*11.

72. *Id.*

73. *Sheldon v. Pinto Tech. Ventures, L.P.*, 220 A.3d 245, 251–52 (Del. 2019).

74. *Id.* at 250.

75. *Id.*



## 4. Key takeaway

As the first Delaware Supreme Court decision to address the standard for determining a control group, this decision immediately became the leading authority on the legally significant connection standard. The Supreme Court's approach of analogizing the facts of a case to the earlier precedents provided a model used in future decisions applying that standard.

### E. *Silverberg v. Padda*<sup>76</sup>

In *Silverberg v. Padda*, the Court of Chancery partially granted a motion to dismiss claims brought by common stockholders who alleged that the directors of Health Integrated Inc. ("HII" or the "Company") breached their fiduciary duties by approving a sale in which common stockholders received no consideration.<sup>77</sup> In its ruling, the court ruled that plaintiffs had not adequately alleged the existence of a control group to retain standing under *Gentile*.<sup>78</sup>

### 1. Background

At various times, HII received financing from private investors by issuing both preferred shares and convertible debt.<sup>79</sup> The plaintiffs' complaint challenged two series of financing transactions and an asset sale.<sup>80</sup> The first series of financing transactions occurred between 2003 and 2012, when multiple venture capital firms invested in several rounds of preferred stock and debt instruments convertible into preferred stock.<sup>81</sup> The second series of financing transactions occurred between 2014 and 2016, when some of the same venture capital firms, as well as others, participated in several offerings of notes and convertible debentures.<sup>82</sup> Then, in June 2016, HII approved a new offering of notes convertible to a new issuance of Series C preferred shares (the "June 2016 New Notes Offering").<sup>83</sup> The Series C preferred shares carried liquidation rights superior to all the other classes of shares,<sup>84</sup> and several firms exchanged their existing securities for notes convertible to Series C preferred shares.<sup>85</sup> All of their shares were exchanged without the investors providing the company with any new capital.<sup>86</sup> Additionally, the June 2016 New Notes Offering modified an existing management equity carve-out equal to five percent of the adjusted enterprise value of the Company that guaranteed distributions to management after Series C preferred stockholders but before any Series B or B-1 preferred stockholders.<sup>87</sup> In December 2017, an affiliate of

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76. 2019 WL 4566909 (Del. Ch. Sept. 19, 2019).

77. *Id.* at \*1.

78. *Id.* at \*7 (citing *Gentile*, 906 A.2d 91).

79. *Id.* at \*2.

80. *Id.* at \*2–3.

81. *Id.* at \*2.

82. *Id.* at \*2–3.

83. *Id.* at \*3.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

Exlservice Holdings, Inc. (“Exlservice”) acquired substantially all of HII’s assets.<sup>88</sup> The \$22 million in consideration satisfied part of the preferred stock’s liquidation preference. The common stockholders received nothing.<sup>89</sup>

## 2. Analysis

The court partially granted a motion to dismiss.<sup>90</sup> The plaintiffs relied on the repeated investments from 2004 and 2016 to show a legally significant connection among a group of funds that collectively held more than 50% of the company’s outstanding voting power.<sup>91</sup> The plaintiffs pointed out that by participating in the same transactions, the VC funds received the same rights,<sup>92</sup> but the court rejected that argument, viewing the allegations as only showing a “parallel interest among the alleged group members,” not a legally significant connection.<sup>93</sup> The court explained that because determining whether a control group exists is fact intensive and difficult to ascertain at the motion to dismiss stage, a “formal written agreement” or “blood pact” is not necessary to prove a legally significant connection on the pleadings.<sup>94</sup> However, plaintiffs must show that the alleged group intended to work together toward a shared goal through a contract, common ownership, an agreement, or some other arrangement rather than allege they had “parallel interests.”<sup>95</sup>

The plaintiffs also alleged “that the venture capital fund defendants shared an unspoken *quid pro quo*, whereby each of their board representatives approved current offerings in consideration for past or future support from other venture capital funds.”<sup>96</sup> The court also declined to credit that argument, reasoning that the plaintiffs failed to allege that the funds were connected “in a legally significant way” as to “voting, decision-making, or other agreements that bear on the transaction[s].”<sup>97</sup> Therefore, the court concluded that even at the plaintiff-friendly motion to dismiss stage, plaintiffs’ allegations did not support a reasonable inference of a control group and the fiduciary claims are therefore derivative.<sup>98</sup>

## 3. Key takeaway

The *Silverberg* court’s analysis builds on the reasoning in *Pinto* and illustrates the difficulties in pleading a control group. Under *Silverberg*, the joint amendment of a corporate document or the approval of challenged transactions is not sufficient to make stockholders a control group.

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88. *Id.*

89. *Id.*

90. *Id.* at \*13.

91. *Id.* at \*6.

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.* at \*7.

97. *Id.*

98. *Id.*

## F. *Garfield v. BlackRock Mortgage Ventures, LLC*<sup>99</sup>

In *Garfield v. BlackRock*, the Court of Chancery denied a defendant's motion to dismiss a stockholder's challenge to the fairness of a reorganization, ruling that the stockholder plaintiff's complaint supported a reasonably conceivable inference that two institutional investors constituted a control group.<sup>100</sup> The court credited the allegations that two institutional investors exercised at least transaction-specific control because they stood to receive unique benefits from the transaction, had unilateral rights under the operating agreement to veto the reorganization, and had the right to designate four of the eleven board members of the parent corporation.

### 1. Background

During the 2008 financial crisis, BlackRock, Inc. ("BlackRock") and Highfields Capital Management ("HC Partners") formed Private National Mortgage Acceptance Company, LLC ("PennyMac, LLC") for the purpose of acquiring loans from financial institutions seeking to reduce mortgage exposure.<sup>101</sup> PennyMac LLC then formed a public REIT and sold 93.5% of the REIT's shares to public investors and 6.5% of its shares to BlackRock, HC Partners, and management.<sup>102</sup>

In 2013, the parties completed an "Up-C" transaction to place a new publicly traded corporation, PennyMac, Inc. (collectively with PennyMac, LLC, "PennyMac") above PennyMac, LLC.<sup>103</sup> PennyMac, Inc. issued Class A common stock to the new public stockholders.<sup>104</sup> These Class A common stockholders owned 15% of the voting rights and 100% of the economic rights in PennyMac, Inc. The corporation also issued Class B common stock to existing PennyMac, LLC Unitholders (the "LLC Unitholders") that carried the remaining 85% of the voting rights of PennyMac.<sup>105</sup> The Up-C offering documents described BlackRock and HC Partners as "strategic investors/partners."<sup>106</sup> The Up-C structure was designed in part to allow the LLC Unitholders to realize tax benefits.<sup>107</sup>

In 2018, Kurland proposed a reorganization that would allow the LLC Unitholders to exchange their units for common stock in a tax-free exchange.<sup>108</sup> The proposed reorganization required a majority vote of the PennyMac stockholders voting as a single class, and so Kurland, BlackRock, and HC Partners could deliver the necessary vote.<sup>109</sup> The

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99. 2019 WL 7168004 (Del. Ch. Dec. 20, 2019).

100. *Id.* at \*1.

101. *Id.*

102. *Id.* at \*2.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.* at \*3.

109. *Id.*

Board established a special committee to evaluate the reorganization.<sup>110</sup> The special committee recommended the full board approve the reorganization, which it did.<sup>111</sup>

Before final approval, HC Partners and BlackRock sought, and the board approved, a new provision that required the consent of HC Partners and BlackRock to terminate the reorganization.<sup>112</sup>

After stockholders approved the reorganization and it closed, a Class A stockholder sued the BlackRock, HC Partners and PennyMac directors who did not serve on the special committee, alleging that BlackRock and HC Partners constituted a control group.<sup>113</sup> The plaintiff argued that the reorganization created benefits for the defendants who held units in the LLC, but not for the stockholders who held Class A common stock in PennyMac.<sup>114</sup> The defendants moved to dismiss, arguing that they should obtain the deference of the business judgment rule because the reorganization was cleansed under *Corwin*.<sup>115</sup>

## 2. Analysis

The court declined to dismiss the plaintiff's claim, ruling that the plaintiff alleged sufficient facts to allow the court to infer that BlackRock and HC Partners constituted a control group, rendering entire fairness the proper standard of review.<sup>116</sup> The court first focused on the following allegations: (i) BlackRock and HC Partners controlled 46.1% of the voting stock, (ii) they had unilateral rights to block the reorganization, and (iii) they each had the right to appoint two representatives to the Board for a total of four out of eleven.<sup>117</sup>

Having decided that "control" was adequately alleged, the court then applied the "legally significant connection" test to determine if BlackRock and HC Partners could be treated as a group, describing that "an array of plus factors" suggested both historical ties and transaction-specific ties.<sup>118</sup> There was a ten year history of co-investment in PennyMac with no gaps, along with that documents that referred to them interchangeably as "Sponsor Members" and strategic partners, plus public disclosures similarly using similar nomenclature.<sup>119</sup> There were also transaction-specific ties including: (i) management meeting with BlackRock and HC Partners multiple times before ever presenting Kurland's proposal to the Board; (ii) management not meeting with BlackRock and HC Partners separately; (iii) management meeting jointly with BlackRock and HC Partners to negotiate the Reorganization and granting them preferential review before the Board had considered the proposal; (iv) management's presentations depicting BlackRock and HC Partners as a collective unit; and (v) BlackRock and HC Partners' ultimate success in securing "a late-in-the-game revision in the form of an exclusive [termination right]."<sup>120</sup>

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110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* at \*7

115. *Id.* (citing *Corwin*, 125 A.3d 304).

116. *Id.* at \*12.

117. *Id.* at \*8.

118. *Id.* at \*9.

119. *Id.*

120. *Id.* at \*9–10.

The court rejected the Defendants' argument that the interests of BlackRock and HC Partners were not aligned due to differential tax treatment, explaining that "despite the distinguishable tax differences, BlackRock and HC Partners shared an interest in gaining a maximum percentage of the combined entity by optimizing the exchange ratio."<sup>121</sup> The court also rejected Defendants' argument that there could be no reasonable inference of a control group because no written agreement executed by BlackRock and HC Partners provided them rights in connection with the reorganization.<sup>122</sup>

The court noted that a lack of formal or written agreement pertaining to the transaction is not fatal, and that the totality of the facts made it reasonably conceivable at the pleading stage that BlackRock and HC Partners were a control group.<sup>123</sup>

### 3. Key Takeaway

The *Garfield* case demonstrates that the control group test is a holistic analysis in which the existence of multiple "plus" factors can support an inference of a control group.<sup>124</sup> While no single historic or transaction-specific tie standing alone would have been sufficient, the factors taken together were enough. *Garfield* also makes clear that just as with a single stockholder, a control group does not need to own a majority of the company's voting power to be deemed to have control.<sup>125</sup>

#### G. *In re USG Corporation Stockholder Litigation*<sup>126</sup>

In this opinion, the court granted a motion to dismiss claims brought by former USG Corporation ("USG") stockholders alleging breaches of fiduciary duty in connection with USG's sale to a strategic buyer ("Knauf").<sup>127</sup> Again applying the "legally significant" connection test from recent precedent, the court held that plaintiffs had not adequately pled the existence of a control group.

#### 1. Background

USG was a manufacturer and distributor of building materials.<sup>128</sup> Knauf beneficially owned approximately 10.6% of USG's outstanding common stock at the time that the merger agreement was executed (the "Merger Agreement"), and had done multiple transactions with USG (including a joint venture and purchasing a USG division).<sup>129</sup> Berkshire initially acquired a stake in USG in 2000 on the open market.<sup>130</sup> Berkshire later provided a backstop

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121. *Id.*

122. *Id.*

123. *Id.* at \*10–11.

124. *Id.*

125. *Id.*

126. 2020 WL 5126671 (Del. Ch. Aug. 31, 2020). It should be noted that in chronological order, a decision in *Skye Mineral Investors, LLC v. DXS Capital (U.S.) Ltd.*, 2020 WL 881544, (Del. Ch. Feb. 24, 2020) comes next. We have omitted *Skye Minerals* because it involved a limited liability company rather than a corporation and dealt with unique features of that entity.

127. *USG*, 2020 WL 5126671 at \*1, \*3.

128. *Id.* at \*3.

129. *Id.*

130. *Id.*

commitment to purchase USG shares as part of a rights offering, and through those purchases and subsequent open market purchases and transactions involving convertible notes, increased its ownership to approximately 31% of the outstanding stock.<sup>131</sup>

In 2017, Knauf contacted Berkshire about acquiring Berkshire's stake for \$40 per share.<sup>132</sup> Knauf subsequently proposed to USG to acquire all of its common stock for \$40.10 per share.<sup>133</sup> The Board discussed the offer and the possibility of a hostile takeover by Knauf, which Berkshire could support because of its interest in exiting its investment in USG.<sup>134</sup> The Board believed that USG's intrinsic value was \$50 per share, and it rejected Knauf's proposal as "inadequate and insufficient."<sup>135</sup>

In 2018, Knauf proposed to acquire USG for \$42 per share and indicated that Knauf and Berkshire could launch a tender offer if USG refused to negotiate in good faith.<sup>136</sup> Berkshire later gave Knauf an option to purchase its USG shares for \$42 per share.<sup>137</sup> When USG rejected Knauf's proposal as inadequate, Knauf successfully carried out a withhold campaign for four of USG's director nominees.<sup>138</sup> After that, USG agreed to a deal at \$44 per share.<sup>139</sup> After the deal closed, a USG stockholder challenged the transaction as a breach of duty and alleged that Knauf and Berkshire constituted a control group.

## 2. Analysis

The court granted the defendant's motion to dismiss.<sup>140</sup> The plaintiffs conceded that the alleged control group "never entered a meeting of the minds" and that Berkshire's interests were "allied with the other unaffiliated stockholders."<sup>141</sup> Although the complaint's allegations supported an inference that both Knauf and Berkshire sought a sale of USG, their "interests diverged regarding the most important detail of the Acquisition: the price."<sup>142</sup> Berkshire wanted to sell its USG shares at the highest possible price. Knauf wanted to buy USG at the lowest possible price.<sup>143</sup> The court described the allegations about the withhold campaign as merely suggesting concurring self-interest rather than the

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131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.* at \*6, \*19.

136. *Id.* at \*6.

137. *Id.* at \*7.

138. *Id.*

139. *Id.* at \*11.

140. *Id.* at \*31.

141. *Id.*

142. *Id.*

143. *Id.*

existence of a control group.<sup>144</sup> As a result, the court ruled that plaintiffs did not adequately plead the existence of a control group.<sup>145</sup>

### 3. Key Takeaway

*USG* shows that sometimes plaintiffs have weak cases. The opinion focused on the relationship of the alleged control group as they sat at the negotiating table. The court's conclusion makes clear that the interests of the alleged group members must align. Being on opposite sides of that table with incentives to negotiate for a better deal at the expense of the other is a factor that weighs strongly against the existence of a control group.<sup>146</sup>

#### H. *In re Tilray, Inc. Reorganization Litigation*<sup>147</sup>

In *In Re Tilray Inc. Reorganization Litigation*, the court denied a motion to dismiss claims brought by the minority stockholders of Tilray, Inc. ("Tilray") who alleged that Tilray's directors and the founders of Privateer, a private equity firm with a majority stake in Tilray, breached their fiduciary duties by entering into a down-stream merger to gain a tax benefit not available to the minority stockholders.<sup>148</sup> The court credited that the plaintiffs adequately alleged the existence of a control group.

#### 1. Background

In 2010, three friends quit their jobs to form Privateer, a private equity firm engaged in investing in the cannabis industry.<sup>149</sup> The "Founders," as the court referred to them, held a 70% voting stake in Privateer, and eventually they formed Tilray as a subsidiary to conduct cannabis research, cultivation, and distribution.<sup>150</sup> Privateer took Tilray public at \$17 per share, bringing the value of Privateer's shares in Tilray to \$1.275 billion.<sup>151</sup> In connection with the IPO, Privateer's shares converted into Class 1 common stock, carrying ten votes per share, while Tilray offered nine million shares of Class 2 common stock, carrying one vote per share, to the public. When the IPO closed, Privateer held a 75% economic interest in Tilray and controlled over 90% of its voting power.<sup>152</sup>

The Founders desired to access some of their new-found wealth but could not do so without incurring significant tax liabilities. Plus, significant sales could cause Tilray's stock price to plummet. To address these issues, the Founders

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144. *Id.*

145. *Id.*

146. *Id.*

147. 2021 WL 2199123 (Del. Ch. June 1, 2021). Chronologically, *In re Pattern Energy Group Inc. Stockholders Litigation*, 2021 WL 1812674 (Del. Ch. May 6, 2021) is next. That decision has a lengthy discussion of the "soft power" that can lead to a control group, but said that because the "inquiry is highly fact intensive," it was "declin[ing] to make a definitive determination" on the issue, and instead would analyze it "after the record is developed through discovery." 2021 WL 1812674 at \*46. Given that approach, we have not included an analysis of that discussion.

148. 2021 WL 2199123, at \*1.

149. *Id.* at \*1.

150. *Id.* at \*2.

151. *Id.*

152. *Id.* at \*3.

contemplated a two-step reorganization of Privateer and Tilray (the “Reorganization”).<sup>153</sup> The first step involved spinning-off Privateer’s other portfolio companies. The second step involved a downstream merger in which Tilray would cancel Privateer’s Tilray stock and issue Tilray stock to Privateer’s stockholders.<sup>154</sup> The IRS would treat the share cancellation and subsequent stock issuance as a tax-free reorganization, allowing the Founders to avoid the tax consequences of a sale or distribution of its Tilray stock while maintaining control over Tilray.<sup>155</sup>

After the company completed the steps of the reorganization, including closing on the downstream merger, plaintiffs, holders of Tilray Class 2 stock, challenged the Reorganization, claiming that the Founders, working as a control group with Privateer, used the Reorganization to perpetuate control over Tilray and used the Reorganization to extract non-ratable tax benefits from Tilray and its minority stockholders.<sup>156</sup> The plaintiffs also brought a derivative breach of fiduciary duty claim against Tilray and certain Tilray directors.<sup>157</sup> The defendants argued that the complaint failed to adequately allege that the Founders comprised a control group.

## 2. Analysis

The court denied the motion to dismiss in its entirety, concluding the plaintiffs had adequately alleged that the Founders and Privateer constituted a control group given the many ties—both historical and transactional—among them.<sup>158</sup> The court, discussing the recent precedent and the “spectrum” described in *Sheldon*, concluded that “the control-group allegations as to the Founders veer far toward the *Hansen* side of the spectrum and perhaps state a stronger case than the allegations in *Hansen*.”<sup>159</sup> These allegations included that the individuals had a long-time friendship, co-founded Privateer and other companies together, worked in the same office space, retained joint advisors, and acted as voting block when approving for the Reorganization.<sup>160</sup> The Founders also had a shared interest of avoiding massive tax liability through the Reorganization—an interest unique to the Founders and not shared by the minority stockholders—which motivated the Founders to act in lock-step in structuring and approving the Reorganization and exerting control.<sup>161</sup>

## 3. Key Takeaway

The *Tilray* decision confirms the fact intensive nature of the analysis and the importance of historical ties. In *Tilray*, the longstanding social ties between the individuals supported an inference of shared goals and motivations. The member of the alleged group also received a unique benefit from the transaction. Taken as a whole, these facts supported the existence of a control group.

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153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.* at \*8.

157. *Id.*

158. *Id.* \*10–11.

159. *Id.* at \*11.

160. *Id.*

161. *Id.* at \*11.



## I. *Patel v. Duncan*<sup>162</sup>

In *Patel v. Duncan*, the Court of Chancery dismissed claims by a stockholder of Talos Energy, Inc. ("Talos") alleging that two private equity funds, Riverstone and Apollo, who collectively held a majority of stock in Talos, comprised a control group and caused Talos to overpay in two transactions that allegedly unfairly benefited affiliates of the two private equity funds.<sup>163</sup> In so ruling, the court held allegations that Riverstone and Apollo comprised a control group to be insufficient.

### 1. Background

In 2012, defendant Timothy Duncan formed the original Talos entity, backed by private equity funds affiliated with Riverstone and Apollo.<sup>164</sup> Talos eventually combined with Stone Energy Corporation ("Stone Energy"). Riverstone and Apollo entered a stockholders' agreement that permitted them to appoint a majority of the board. After the combination, Riverstone and Apollo owned a majority of the company's voting power.<sup>165</sup> The company's public disclosures described it as a "controlled company" under applicable New York Stock Exchange (NYSE) Rules, stating: "We are controlled by Apollo Funds and Riverstone Funds. The interests of Apollo Funds and Riverstone Funds may differ from the interests of our other stockholders."<sup>166</sup>

During this time period Riverstone and Apollo worked together on other transactions that failed. Those were a \$7.2 billion buyout of an entity that then declared bankruptcy (causing Apollo to lose over \$2 billion and Riverstone over \$600 million), as well as a loan Apollo provided to an entity known as Whistler, which went bankrupt and cost Apollo over \$100 million, though it received the right to distributions until it was paid back on its original loans. Talos eventually acquired Whistler, allegedly making Apollo nearly whole on its Whistler investment. The plaintiff alleged that Talos overpaid for Whistler to bail out Apollo, which Riverstone went along with based on an understanding that it would get its own "sweetheart" deal.

That opportunity presented itself in 2019 when Talos acquired a portfolio of assets from entities affiliated with Riverstone (the "Challenged Transaction").<sup>167</sup> The plaintiff alleged that Talos "grossly overpaid" in the Challenged Transaction to follow through on getting Riverstone a "sweetheart" deal.<sup>168</sup>

The plaintiff alleged that the terms of the Challenged Transaction were unfair to Talos, including by providing the sellers with a new series of stock rather than common stock.<sup>169</sup> The plaintiff alleged that the transaction structure did not benefit Talos but rather enabled the Challenged Transaction to close more quickly without the need for a stockholder vote.<sup>170</sup>

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162. 2021 WL 4482157 (Del. Ch. Sept. 30, 2021), *corrected* (Oct. 4, 2021), *aff'd* 277 A.3d 1257 (Del. May 25, 2022) (TABLE).

163. *Id.* at \*1.

164. *Id.* at \*2.

165. *Id.* at \*3.

166. *Id.*

167. *Id.* at \*5–6.

168. *Id.* at \*6–7.

169. *Id.* at \*5–6.

170. *Id.* at \*5–7.

The plaintiffs alleged that Apollo and Riverstone breached their fiduciary duties as controlling stockholders. The defendants moved to dismiss.

## 2. Analysis

The court granted the motion to dismiss. In arguing that a control group existed, plaintiff pointed to four factors: (1) Apollo and Riverstone's historical relationship, including Talos's purchase of Whistler; (2) Talos's disclosure that it was a controlled company, (3) the stockholders' agreement permitting Apollo and Riverstone to appoint a majority of the Board's directors, and (4) the participation of representatives from Riverstone and Apollo in the meetings where the Board discussed the Challenged Transaction.<sup>171</sup>

The court determined that the alleged historical ties between Riverstone and Apollo were weaker than those found in cases like *Garfield* and *Hansen*, distinguishing those cases and explaining that while the relationship between Riverstone and Apollo within Talos was significant, the two firms crossed paths in only one other transaction.<sup>172</sup> Second, the court determined that the public disclosure was relevant, but only addressed an NYSE rule.<sup>173</sup> Third, the court viewed the stockholder's agreement as non-dispositive because the agreement allowed them to appoint a majority of directors did not bear on the Challenged Transaction or bind them beyond selecting directors.<sup>174</sup> Fourth, the court brushed aside the argument that the mere existence of representatives at the Board meeting discussing the Challenged Transaction was suggestive of a control group, deciding that the presence of controlling stockholders at such a meeting to be expected.<sup>175</sup>

Having given little credence to the alleged "plus factors," the court declined to credit the *quid pro quo* arrangement. The court concluded by stating:

In the end, Plaintiff's most significant pleading deficiency lies in the failure of his *quid pro quo*, the only argument he makes to support a transaction-specific agreement between [Apollo and Riverstone]. Though it is true Riverstone and Apollo have coinvested in Talos and crossed paths previously, the absence of any allegation or indication that they struck an agreement to work together, as in *Silverberg*, is fatal to Plaintiff's theory.<sup>176</sup>

This decision was appealed to the Delaware Supreme Court, which affirmed in a one page order stating the en banc court found "it evident that the judgment of the Court of Chancery should be affirmed on the basis of and for the reasons stated in the court's Memorandum Opinion dated October 4, 2021."<sup>177</sup>

## 3. Key Takeaway

*Patel* confirms that despite being a fact intensive analysis at the plaintiff-friendly pleading stage, the court is willing to grant a motion to dismiss without sufficient allegations. Importantly, the plaintiff's only transaction-specific tie

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171. *Id.* at \*11.

172. *Id.* at \*11–13.

173. *Id.* at \*12.

174. *Id.* at \*13.

175. *Id.* at \*14.

176. *Id.* at \*16.

177. *Patel v. Duncan*, 277 A.3d 1257 (Del. May 25, 2022) (TABLE).

alleged in this case was a *quid pro quo* between the alleged controlling parties, but the complete lack of any informal or formal agreement between the alleged controllers caused such argument to fail.

The lack of transaction-specific factors alleged, combined with the weakness of the alleged non-transaction specific "plus factors" was insufficient.<sup>178</sup>

### III. TAKEAWAYS FROM RECENT DECISIONS

The recent decisions, read together, demonstrate the court's reluctance to sustain control group allegations, perhaps even more so than in the context of a single controller.<sup>179</sup> The result is a clear difficulty to plead the existence of a control group. In six of the nine decisions issued since 2017 (*Yates*, *Carr*, *Sheldon*, *Silverberg*, *USG*, and *Patel*), the court ruled the plaintiff had not sufficiently pled the existence of a control group. When one considers the gravity of the "controlling stockholder" designation,<sup>180</sup> this reluctance is understandable.<sup>181</sup> It avoids eroding the business judgment rule through increasing second guessing of corporate actions that merely had the support of multiple "stockholders united only by a common view of what will optimize the value of their shares,"<sup>182</sup> and recognizes the difference required in between a single controller and a control group.<sup>183</sup> *Patel* thus punctuates the series by reiterating "[w]hile the plaintiff-friendly pleading standard and fact-intensive nature of the control group inquiry loom large at this stage, these concerns do not

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178. There was one additional decision issued by the Court addressing a control group argument. In *Lockton v. Rogers*, 2022 WL 604011 (Del. Ch. Mar. 1, 2022), the plaintiff alleged that the various members of the board themselves made up a control group. The court rejected the argument, concluding they merely had "parallel interests." *Id.* at \*14. We do not elaborate further because the claim that the directors, who already owed fiduciary duties, should be held to be a control group is an outlier not addressed in other opinions that focused on whether the fiduciary duty obligations of a controlling stockholder should be imposed on a group of stockholders who otherwise did not owe fiduciary duties.

179. See *In re Crimson Expl. Inc. S'holder Litig.*, 2014 WL 5449419, at \*12 (Del. Ch. Oct. 24, 2014) ("Absent a significant showing such as was made in these prior cases, the courts have been reluctant to apply the label of controlling stockholder—potentially triggering fiduciary duties—to large, but minority, blockholders.").

180. See *Patel*, 2021 WL 4482157, at \*10 ("Plaintiff's theory that the Venture Capital Defendants formed a control group is the central feature in the Complaint. The viability of this theory informs the standard of review, the availability of breach of fiduciary duty claims against the Venture Capital Defendants, and the number of Board members that may be considered interested in the Challenged Transaction.") (emphasis added); see also Lipton, *supra* note 19, at 827 ("Under Delaware doctrine, a single label—controlling shareholder—carries an enormous amount of legal weight. Once the label is applied to a person or institution, that entity is immediately subject to unique legal treatment along three distinct dimensions."); Note, *Controller Confusion: Realigning Controlling Stockholders and Controlled Boards*, 133 HARV. L. REV. 1706, 1712 (2020) (stating "controlling stockholder status remains significant, both for the individual in acquiring fiduciary duties and for the board that may find its decisions subject to heightened scrutiny and difficult to cleanse").

181. There admittedly is disagreement about whether Delaware law has found a satisfying resting place. Compare Lawrence A. Hamermesh, Jack B. Jacobs, Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 347 (2022) (describing downsides of expanding the definition of control group and praising the Delaware Supreme Court's decision in *Sheldon*, and subsequent decisions such as *Patel*, as "cabin[ing] th[at] danger," while criticizing *Hansen* and other decisions as "troublesome") with Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REG. 1124, 1170 (2021) (noting mistake of thinking "there is a simple answer that the Delaware Supreme Court missed" in *Sheldon* while proposing "approach build[ing] on a truth [*Sheldon*] ignores concerning aggregating ownership of significant blockholders").

182. Lawrence A. Hamermesh, Jack B. Jacobs, Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 347 (2022).

183. Da Lin, *Beyond Beholden*, 44 J. CORP. L. 515, 518–19 (2019) (describing findings that are "consistent with classic narratives about power: a single person with consolidated control has greater power to reward or sanction than a group of decision-makers who share control because the single person can act unilaterally and her authority over the controlled company is plenary").

require the Court to ‘pile up questionable inferences until such a conclusion is reached.’”<sup>184</sup> Although the Supreme Court quickly affirmed *Patel* by order rather than issuing a written opinion (as it had done in *Sheldon*), this should only emphasize the precedential value of the Chancery opinion.<sup>185</sup>

But difficult does not mean impossible, and by explaining which facts constitute sufficiently persuasive allegations of concerted action to plead control, the decisions also animate a key principle underlying Delaware’s *MFW* jurisprudence, which is that stockholders are best protected by proactively implementing procedural protections.<sup>186</sup> In the three decisions denying motions to dismiss it is hard to deny that the pled connections reflected significant power to influence the company.<sup>187</sup> In *Hansen* that was a two-decade long history of investing together that continued with multiple investments in the company at issue, and direct negotiations with the acquirer.<sup>188</sup> In *Garfield*, that included coordinated involvement that led to the company describing the stockholders as “strategic partners,” who had preferential input and influence on the transaction.<sup>189</sup> In *Tilray* it took the form of the company’s founders, who had strong personal ties, working toward a shared goal of minimizing tax liabilities associated with early investments, which was not an issue for other stockholders.<sup>190</sup> These are all fact patterns consistent with the increasing complexity of corporate capital and stockholder structures described above. Although a common thread between the decisions, it is not an outcome dispositive one. The powers and rights of the stockholders in *Hansen*, *Garfield*, and *Tilray* were specifically those associated with venture capital or early investors, and the transactions in *Garfield* and *Tilray* were complicated reorganizations, rather than third party mergers. Yet *Yates* and *Sheldon* dealt with similar allegations and relationships, and multiple opinions analyzing a single stockholder make clear that specific powers such as a blocking right “standing alone [are] highly unlikely to support either a finding or a reasonable inference of control.”<sup>191</sup>

All of this means—perhaps for the better—that control group status is not something investors are likely to stumble into unwittingly. The added clarity connects with another principle animating *MFW*, and specifically its *ab initio* requirement, which Delaware courts continue to encourage parties to avail themselves of to avoid litigation risk,<sup>192</sup> because

184. *Patel*, 2021 WL 4482157, at \*11 (citing *In re Crimson Exploration Inc. S’holder Litig.*, 2014 WL 5449419, at \*15 (Del. Ch. 2014)).

185. *Patel*, 277 A.3d 1257; *Sheldon*, 220 A.3d 245.

186. *In re MFW S’holders Litig.*, 67 A.3d 496, 526 (Del. Ch. 2013) (stating “the court concludes that the rule of equitable common law that best protects minority investors is one that encourages controlling stockholders to accord the minority this potent combination of procedural protections”), *aff’d sub nom.* Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

187. As noted in note 149, *supra*, *In re Pattern Energy Group Inc. Shareholders Litigation* arguably fits with these decisions, though technically the court “decline[d] to rule on the Motions to dismiss” the control group allegation “until a later stage in these proceedings.” 2021 WL 1812674, at \*46.

188. 2018 WL 3025525 (Del. Ch. June 18, 2018).

189. 2019 WL 7168004 (Del. Ch. Dec. 20, 2019).

190. 2021 WL 2199123 (Del. Ch. June 1, 2021).

191. *Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC*, 2018 WL 3326693, at \*26 (Del. Ch. July 6, 2018); *see also* *Thermopylae Cap. P’rs, L.P. v. Simbol, Inc.*, 2016 WL 368170, at \*13 (Del. Ch. Jan. 29, 2016) (“Under Delaware law, however, contractual rights held by a non-majority stockholder do not equate to control, even where the contractual rights allegedly are exercised by the minority stockholder to further its own goals.”).

192. *See In re Tesla Motors, Inc. S’holder Litig.*, 2022 WL 1237185, at \*48 (Del. Ch. Apr. 27, 2022) (“Before addressing the merits, I cannot help but observe that Elon (and the rest of the Tesla Board members) likely could have avoided this expensive and time-consuming litigation had they just adopted more objectively evident procedural protections. ... That Elon and the Tesla Board failed to follow this clear guidance and yet prevailed here should not minimize those incentives or dilute the implications of the onerous

stockholders need to know they are controllers in order to implement *MFW*.<sup>193</sup> Uncertainty about whether one is part of a control group decreases the likelihood of utilizing *MFW* because the stockholders may be unwilling to in essence concede they are part of such a group by stating they will abide by *MFW*. Why would one make such a concession if he or she did not think they were part of a control group?

One final point: the decisions discussed in this article all involved pleading-stage motions. One outstanding issue that has yet to play out post-*Corwin* is what it takes parties to succeed at trial in showing there was or was not a control group, after the court had determined on the pleadings that the existence of one was reasonably conceivable.<sup>194</sup> Of the decisions discussed above that denied motions to dismiss and let the claims proceed, *Hansen*, *Garfield*, and *Tilray* have all settled. A similar control issue has been litigated through trial in at least one recent decision, *In re Tesla Motors, Inc. Stockholder Litigation*, though the allegations focused on a single controlling stockholder, rather than a control group.<sup>195</sup> Still that case fit the fact pattern of a defendant after trial arguing that the plaintiffs had failed to prove the existence of a controller, which it turned out was one of a myriad of issues that the court did not decide.<sup>196</sup>

If the control group issue has in fact been adequately addressed, it may be that the facts that would sustain the allegation do not exist. That seems unlikely given the dynamic of increasingly complex and bespoke governance structures described above. If such a case is tried, like all Chancery decisions the outcome will be heavily fact-dependent, turning on a weighing of whether the *allegations* of control that sustained the claims at the pleading stage survived discovery such that they could become *findings of fact*.

#### IV. DELAWARE'S COMMON LAW IN ACTION

What the decisions say is as important as how they were made and what that process shows about how Delaware makes its corporate law. These decisions, issued in about four years, show the "dynamism inherent in the common law

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entire fairness standard of review. Their choices constricted the presumptive path to business judgment deference and subjected Elon's conduct to post-trial judicial second-guessing. In other words, if Chancery opinions are 'parables,' let this be a parable of unnecessary peril, despite the outcome."); *id.* at \*48 n.557 (noting "defense verdicts after an entire fairness review of fiduciary conduct are not commonplace—hence the advisability of structuring transactions to avoid such scrutiny as a matter of law"); see also Ann Lipton, *Will He or Won't He?*, Law Professor Blogs Network (July 17, 2021), [https://lawprofessors.typepad.com/business\\_law/2021/07/will-he-or-wont-he.html](https://lawprofessors.typepad.com/business_law/2021/07/will-he-or-wont-he.html) (stating "some *ex ante* doubt about controller status" may better incentivize boards to "be strict about cleansing mechanisms").

193. See *In re Rouse Props., Inc.*, 2018 WL 1226015, at \*1 n.6 (Del. Ch. Mar. 9, 2018) ("Of course, when the corporation in which the minority blockholder owns shares does not recognize that blockholder as a controlling stockholder, its board of directors has no incentive to implement the dual protections prescribed by *MFW* (affirmed by *M&F Worldwide* [sic]). That, in turn, leaves the board exposed to entire fairness review in the event the court in a post-closing challenge to an allegedly conflicted controller transaction disagrees with the board's assessment and determines that the blockholder is, as a matter of law and fact, a controlling stockholder.").

194. One pre-*Corwin* opinion was decided post-trial, though there is no indication that it followed a motion to dismiss. *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at \*10 (Del. Ch. Aug. 18, 2006).

195. 2022 WL 1237185, at \*1 (Del. Ch. Apr. 27, 2022).

196. *Id.* at \*2 ("Against this factual backdrop, the plaintiffs' claims against [the alleged controller], and [the alleged controller's] defenses, call out like a carnival barker, beckoning the Court to explore a wide range of interesting and arguably unsettled legal issues, including, among others, the contours and nuances of Delaware's controlling stockholder law . . . . To be sure, in answer to the barker's call, it is tempting to venture into each tent and confront the legal enigmas that await there. Given the clarity provided by compelling trial evidence, however, there is no need to take on the challenge of discerning the appropriate standard of review by which to decide the plaintiffs' claims. Even assuming (without deciding) [the existence of a] controlling stockholder, the Tesla Board was conflicted, and the vote of the majority Tesla's minority stockholders approving the Acquisition did not trigger business judgment review, such that entire fairness is the standard of review, the persuasive evidence reveals that the Acquisition was entirely fair.").

process of adjudication” given Delaware’s place at the center of American corporate law.<sup>197</sup> The term common law is often used generally, or as an antonym to a civil law or code jurisdiction, but as others have, we want to be clear about the specific version of common law decision-making that Delaware uses to refine its corporate law.

“In many respects, Delaware’s corporate law may be the last vestige of the classical 19th century common law model in America: most important legal rules are promulgated by a nonpartisan, expert judiciary; these rules are presented as derived from long-standing and widely accepted principles; the law is enforced through civil litigation brought by private parties; and even legislative amendments generate neither debate nor controversy.”<sup>198</sup> These traits of Delaware’s corporate law “represent a rather pure, and therefore rather unfamiliar, form of the common law system.”<sup>199</sup> In this “common law fashion,” the case before the court “is decided and the law is thereby evolved incrementally” with “the overall body of case law coherently fill[ing] in a map that guides transactional and corporate governance advisors in charting a course for their clients that is relatively risk free.”<sup>200</sup>

In practice, this creates, in the words of Vice Chancellor Parsons, a “phenomenon of multiple cases posing different facets of timely questions of corporate law.”<sup>201</sup> This phenomenon is “the natural consequence of the Court of Chancery’s role as the United States’ premier business court,” as the resulting “volume of cases that it hears contributes importantly to this valuable predictability, even in a dynamic economic and capital marketplace.”<sup>202</sup> Thus, “[a]s surely as Rome was built brick-by-brick, so too has Delaware developed its corporate jurisprudence case-by-case.”<sup>203</sup> Former Chief Justice Strine has similarly written “the continued importance of the common law of corporations is not the result of happenstance, but reflects a policy choice made by the Delaware General Assembly. That choice deliberately deploys Delaware’s judiciary to guarantee the integrity of our corporate law through the articulation of common law principles of equitable behavior for corporate fiduciaries.”<sup>204</sup> A distinguished Chancery practitioner describes “[t]he success of the Chancery system” as “depend[ing] on its exposure to, and adjudication of, a large and representative docket of cases challenging transactions with Delaware-incorporated targets. The large size of the docket affords the court the necessary opportunities to develop and refine corporate law in the transactional context.”<sup>205</sup> And there is no shortage of academic articles noting the responsiveness of Delaware’s judiciary to a large volume of “hot” corporate topics as contributing to its

197. Leo E. Strine, Jr., *The Inescapably Empirical Foundation of the Common Law of Corporations*, 27 DEL. J. CORP. L. 499, 513 (2002).

198. Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1577 (2005); see also Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 BUS. LAW. 877, 878 (2005) (stating “many of the important principles of American-style corporate law come in the form of judge-made common law.”).

199. Kahan & Rock, *supra* note 195, at 1610.

200. Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 683 (2005).

201. Donald F. Parsons, Jr. & Jason S. Tyler, *Docket Dividends: Growth in Shareholder Litigation Leads to Refinements in Chancery Procedures*, 70 WASH. & LEE L. REV. 473, 476 (2013); see also *id.* at 524 (“Delaware’s volume of corporate and alternative business entity cases, the fact that those cases are litigated before the relatively small, but expert, Delaware Court of Chancery and Supreme Court, and the responsiveness of its courts, its legislature, and the marketplace generally accelerate the development of refined doctrine, measured balance, and valuable predictability.”).

202. Parsons & Tyler, *supra* note 198, at 476.

203. *Id.* at 483–84.

204. Strine, *supra* note 199, at 879.

205. William Savitt, *The Genius of the Modern Chancery System*, 2012 COLUM. BUS. L. REV. 570, 598 (2012).

success and renown.<sup>206</sup> The above survey of control group decisions, decided in rapid succession after the confluence of *Gentile*, *Corwin*, and changing funding mechanisms and capital structures, presents only one further example of this dynamic playing out in Delaware.

## V. CONCLUSION

The preceding survey describes the development of a robust "spectrum" of decisions that now serve as analogies to help categorize new cases. As a result of the enhanced clarity that has come from the evolution of this body of case law, 2022 saw little further development in the area. A confluence of factors likely led to this development, including (i) *Gentile*'s fall (which we would suggest was at least in part hastened by how frequently such claims were brought in the context of control group arguments), (ii) transactional planners identifying potential control groups and either restructuring transactions or implementing *MFW* style protections to assure the application of the business judgment rule, (iii) plaintiff stockholders not bringing claims that are now weak under the court's precedent, and (iv) defense counsel similarly deciding against bringing weak motions to dismiss. How much each of these factors contributed to the lack of noteworthy developments in 2022 is unclear. But what is clear is that Delaware remains committed to a common law process that refines its corporate law iteratively and quickly, ensuring that it continues to provide valuable guidance to lawyers and their clients dealing with pressing corporate law issues.

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206. See, e.g., Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. RICH. L. REV. 1129, 1159 (2008) ("Delaware courts are often the first responders to corporate law controversies."); Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1063 (2000) ("The large volume of business litigation in Delaware, coupled with Delaware's specialized court system, results in a well developed collection of corporate law precedents.").





## CONQUERING THE CHAOS OF UNCERTAINTY: THE EVOLVING ROLE OF LEGAL REPRESENTATIVES IN PROTECTING THE DUE PROCESS RIGHTS OF FUTURE CLAIMANTS IN MASS TORT CASES

By Roger Frankel, Richard H. Wyron, James L. Patton, Jr.,  
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*Traditional chapter 11 bankruptcy proceedings are not adequately equipped to handle mass tort liabilities arising from latent injuries. A solution has emerged from section 524(g) of the Bankruptcy Code and related precedent in the form of the future claimants' representative or "FCR." The FCR acts as a representative for future claimants who would otherwise be unable to seek recovery through bankruptcy proceedings. This article argues that the FCR—along with the establishment of a channeling injunction and settlement trust—is an effective and elegant solution for both future claimants and debtors in mass tort bankruptcies.*

Companies facing viability-threatening mass tort liability and a seemingly unending stream of litigation may seek protection by filing for bankruptcy.<sup>1</sup> However, injuries arising in asbestos and certain other mass tort cases can have a long latency period between exposure to or use of a defective product and manifestation of harm.<sup>2</sup> As a result, future claimants (*i.e.*, individuals who have been exposed to a defective product but have not yet manifested injury) may be unaware that they hold a claim for their injury at the time that a company files for bankruptcy. The number of these future claimants and the magnitude of their claims often proves difficult to estimate.<sup>3</sup>

In these cases, companies must address future claims to ensure that their reorganizations are meaningful such that they receive an effective extinguishment of current and future claims. In order to address future claims, a company must provide adequate protection for their holders, even though doing so is often in tension with the competing bankruptcy policy of providing the debtor with a fresh start.<sup>4</sup> Appointing a legal representative to protect the interests of

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1. See Alan Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2046 (2000).

2. *Id.* at 2046.

3. Yair Listokin & Kenneth Ayotte, *Protecting Future Claimants in Mass Tort Bankruptcy*, 98 NW. L. REV. 1435, 1435 (2004).

4. See *In re W.R. Grace & Co.*, 13 F.4th 279, 283 (3d Cir. 2021) ("Section 524(g) . . . enables bankruptcy courts to establish a trust for future claimants as part of a debtor company's reorganization plan, and, through the resulting channeling injunction, diverts all claims against the debtor to the trust. This ensures both that future claimants are assured restitution, and that debtor companies can survive bankruptcy without the threat of future asbestos suits."); *In re Energy Future Holdings Corp.*, 949 F.3d 806, 811 (3d Cir. 2020) (noting the "poor fit between our bankruptcy law and asbestos litigation" in that "the long latency period for asbestos-related disease is incompatible with the 'public policy of affording finality to bankruptcy judgments'"); *In re W.R. Grace & Co.*, 729 F.3d 311, 320 (3d Cir. 2013) ("By removing that uncertainty and allowing the debtor to emerge from bankruptcy free of all asbestos liability, § 524(g) facilitates the company's ongoing viability, which in turn provides the trust 'with an evergreen source of funding to pay future claims.' . . . The statute thus furthers two goals: ensuring the equitable resolution of present and future asbestos

future claimants, often called a future claimants' representative or "FCR," has emerged as a means to reconcile this conflict in the mass tort context. The role of an FCR focuses on protecting the due process rights of future claimants.

The ability to provide a final resolution of claims has been especially challenging in the context of asbestos liabilities. In the early 1980s, Manville and UNR, both large producers and suppliers of asbestos-containing products, filed for bankruptcy while facing thousands of lawsuits from asbestos-related deaths and injuries.<sup>5</sup> Pioneers at the time, both of these companies sought to address future claims through use of a channeling injunction, a settlement trust, and the appointment of an FCR.<sup>6</sup> Yet, even with the appointment of a legal representative and the confirmation of the *Manville* and *UNR* chapter 11 plans, there remained uncertainty whether these resolutions would endure, given the courts' untested authority to bind future asbestos claimants.

Then, in 1994, Congress enacted section 524(g) of title 11 of the United States Code (the "Bankruptcy Code"), which confirmed the use of the *Manville* and *UNR* model for other debtors facing asbestos liability.<sup>7</sup> This specialized Bankruptcy Code section was implemented to ensure the "fair and equitable distribution" of an estate's assets to both existing and future claimants.<sup>8</sup> For instance, section 524(g) provides for the resolution of mass asbestos liabilities consistent with due process by authorizing courts to confirm a plan that establishes a permanent injunction channeling all current and future claims to the settlement trust so long as the court appoints an FCR to protect the interests of future claimants during the bankruptcy case.<sup>9</sup> Section 524(g) also conditions issuance of the channeling injunction on multiple additional requirements, such as certain findings about the debtor's liability and other protections for future claimants.<sup>10</sup>

This Article addresses the development of the role of an FCR in mass tort bankruptcy cases.<sup>11</sup> Section II provides an overview of the due process concerns raised when a company seeks to discharge a future or unknown claim in bankruptcy. It also examines the reasons why future claimants need their own legal representation. Section III traces the development of the FCR's role through the *Manville* and *UNR* bankruptcies, the uncertainty of this early model, and the enactment of section 524(g) in response. It also considers how courts have interpreted the role of the FCR. Section IV addresses other ways the legal system has attempted to address future claims in mass tort class actions and bankruptcy,

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claims, and 'enabling corporations saddled with asbestos liability to obtain the "fresh start" promised by bankruptcy.'" (quoting *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 234 (3d Cir. 2005) and *In re Federal-Mogul Glob., Inc.*, 684 F.3d 355, 359 (3d Cir. 2012)); *Wright v. Owens Corning*, 679 F.3d 101, 106 (3d Cir. 2012), *cert. denied*, 568 U.S. 1157 (2013) ("Consideration of the treatment of unknown future claims involves two competing concerns: the Bankruptcy Code's goal of providing a debtor with a fresh start by resolving all claims arising from the debtor's conduct prior to its emergence from bankruptcy; and the rights of individuals who may be damaged by that conduct but are unaware of the potential harm at the time of the debtor's bankruptcy."); *In re RailWorks Corp.*, 621 B.R. 635 (Bankr. D. Md. 2020) (noting the "often-harsh" reality of balancing the debtor's rights with those of creditors).

5. See *In re Joint E. & S. Dists. Asbestos Litig.*, 129 B.R. 710, 751 (E.D.N.Y. & S.D.N.Y. 1991), *vacated on other grounds*, 982 F.2d 721 (1992), *modified*, 993 F.2d 7 (2d Cir. 1993); *In re UNR Indus., Inc.*, 71 B.R. 467, 472 (Bankr. N.D. Ill. 1987).

6. See *In re Johns-Manville Corp.*, 68 B.R. 618 (Bankr. S.D.N.Y. 1986), *aff'd sub nom. In re Johns-Manville Corp.*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd sub. nom. Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988); *In re UNR Indus., Inc.*, 46 B.R. 671 (Bankr. N.D. Ill. 1985).

7. 11 U.S.C. § 524(h), enacted at the same time as section 524(g), sanctioned the trust model utilized by debtors like *Johns-Manville* and *UNR* prior to enactment of section 524(g).

8. See 11 U.S.C. § 524(g)(4)(B)(ii).

9. 11 U.S.C. §§ 524(g)(1)(B), (4)(B)(i).

10. 11 U.S.C. § 524(g)(2)(B)(ii).

11. Section 524(g) by its terms applies only to liability for asbestos. This Article argues that the policy behind and the framework set forth in section 524(g) can and should be applied to other "mass torts."

and why they have been largely unsuccessful in providing certainty for those facing mass tort liability. Section V argues that the use of FCRs in non-524(g) mass tort bankruptcy cases serves the same goals that Congress prioritized in section 524(g) and provides additional contexts in which the appointment of an FCR is appropriate moving forward.

Use of section 524(g) as a framework, buttressed by the bankruptcy court's equitable powers to address other liabilities, has made reorganizing under the Bankruptcy Code an appealing pathway for companies struggling with mass tort liabilities that include future claims.<sup>12</sup> In addition to providing fair treatment for both current and future claimants, the trust model has been effective in reducing problems in mass tort litigation, like transaction costs and attorneys' fees.<sup>13</sup> This Article argues that following the section 524(g) model of appointing an FCR, establishing a settlement trust, and employing an injunction to channel liabilities to that trust for resolution is the only proven way to address due process concerns for future claimants in asbestos and non-asbestos mass tort cases. While this model does not fit every case, it is supported by more than twenty-five years of precedent, protects the interests of future claimants in the long term by ensuring equitable treatment and a source of compensation, and offers a level of certainty for the reorganizing debtor that seeks a fresh start free of crippling mass tort liabilities.

## I. CHALLENGES WITH DISCHARGING FUTURE CLAIMS IN A CHAPTER 11 REORGANIZATION

Often in chapter 11 cases, a bar date for the filing of proofs of claim is set, and claims filed before the bar date receive treatment under the terms of a proposed plan of reorganization.<sup>14</sup> Upon confirmation of that plan, any claims that arose prior to confirmation are discharged, and any attempts to collect from the debtor or against the debtor's property on account of such claims are enjoined.<sup>15</sup> While this framework typically provides finality to a debtor, it presents unique challenges when dealing with future claims.

A future claim in the bankruptcy context is a claim for which some seed that will ultimately lead to a compensable injury has been sown, but the fruit has not yet ripened. A future claimant is, generally, a person whose claim is not capable of being fairly addressed because it is not fully developed at the time a court is addressing the liability of the debtor and, potentially, other third parties that have been alleged co-liable with the debtor. The majority of future claims arise under two types of situations: (1) where a defective product has been put into the stream of commerce, but the claimant does not come into contact with it and experience injury until after confirmation of the plan of reorganization; and (2) where the claimant has been exposed to the defective product before, but the injury does not manifest until after, confirmation of such plan.<sup>16</sup>

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12. See *In re Federal-Mogul Glob., Inc.*, 684 F.3d 355, 359 (3d Cir. 2012) ("A consequence of the failure to create a comprehensive resolution to asbestos litigation has been a reliance on the Bankruptcy Code to provide some predictability and regularity in addressing mass tort liability. Bankruptcy has proven an attractive alternative to the tort system for corporations because it permits a global resolution and discharge of current and future liability, while claimants' interests are protected by the bankruptcy court's power to use future earnings to compensate similarly situated tort claimants equitably.").

13. *Id.* at 362 (noting that other problems, like "reconciling competing interests of present and future claimants, are not limited to the creation of § 524(g) trusts, but extend to the current state of asbestos and mass tort litigation generally").

14. See *In re Energy Future Holdings Corp.*, 949 F.3d 806, 811 (3d Cir. 2020).

15. See 11 U.S.C. §§ 524(a), 1141(d)(1)(A).

16. The dischargeability of such future claims is of questionable constitutionality at best. See Rosemary Reger Schnall, *Extending Protection to Foreseeable Future Claimants Through Delaware's Innovative Corporate Dissolution Scheme—In re Rego Co.*, 19 DEL. J. CORP. L. 141, 141–43 (1994); *Treating Latent Medical Tort Claims in Bankruptcy*, 21 AM. BANKR. INST. J. 18, July/August 2002.

Whether a debtor and related third parties can obtain protection from future claims in the form of discharge, release, or a channeling injunction upon confirmation of a company's chapter 11 plan of reorganization generally turns on two things: (1) whether the future claim existed at the time of the bankruptcy proceeding<sup>17</sup> and (2) whether such protection comports with future claimants' due process rights.<sup>18</sup>

### A. When Did the Future Claim Arise Under the Bankruptcy Code?

While the Bankruptcy Code purposefully defines "claim" broadly,<sup>19</sup> such breadth is not unlimited. Moreover, confirmation of a chapter 11 plan only discharges claims that arose before the date of confirmation.<sup>20</sup> Therefore, to determine if a debtor's liability for a future claim will be discharged upon plan confirmation, a determination must first be made as to when the future claim arises under the Bankruptcy Code.

It is not easy to delineate precisely when a claim arises in the context of determining if the future claim is subject to administration and discharge in the bankruptcy, because injuries arising due to asbestos and certain other mass torts can have a long latency period between exposure to or use of a defective product and manifestation of harm.<sup>21</sup> To make this determination, courts typically employ some variation of either (i) the conduct test, which focuses on a claimant's exposure to the debtor's product or conduct, or (ii) the pre-petition relationship test, which focuses on the claimant's relationship with the debtor at the time of exposure to the debtor's product or conduct. Regardless of which test is employed, for a future personal injury claim to be considered a claim under the Bankruptcy Code, courts generally require that a claimant have been exposed pre-petition or pre-confirmation to the debtor's product or other conduct that gives rise to the injury.

#### 1. Conduct Test

Under a strict application of the conduct test, a claim arises at the "moment the conduct giving rise to the alleged liability occurred."<sup>22</sup> Arguably, if a debtor introduced a defective product into the marketplace pre-petition, even persons that did not use or have exposure to the defective product until years after the debtor exited bankruptcy would

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17. Morgan Olson L.L.C. v. Frederico (*In re Grumman Olson Indus., Inc.*), 467 B.R. 694, 696-97 (S.D.N.Y. 2012) ("If a particular cause of action does not fall under the definition of 'claim,' then, for example, it would fall outside the Code provision that 'property dealt with by the plan [of reorganization] is free and clear of all claims.'" (quoting 11 U.S.C. § 1141(c))).

18. See JELD-WEN, Inc. v. Van Brunt (*In re Grossman's Inc.*), 607 F.3d 114, 125-26 (3d Cir. 2010) (*en banc*) (stating that claims that otherwise are subject to discharge are not discharged if "fundamental principles of due process" have not been satisfied).

19. See 11 U.S.C. § 101(5) (defining a claim as "(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.").

20. See 11 U.S.C. § 1141(d)(1)(A). There is no discharge if the company fails to engage in business after the plan is consummated. See *id.* § 1141(d)(3)(B). In cases where there is a lag between confirmation of the plan and the effective date of the plan, the Third Circuit held that the language of section 1141(d)(1) permits the plan or confirmation order to provide that claims that arise after confirmation but prior to the effective date are subject to discharge. See *Ellis v. Westinghouse Elec. Co., LLC*, 11 F.4th 221, 238 (3d Cir. 2021).

21. See *In re Grumman*, 467 B.R. at 696-97 (noting that the purposefully broad scope of "claim" as defined by Congress, "points us in the right direction, but provides little indication of how far we should travel").

22. See *Lemelle v. Universal Mfg. Corp.*, 18 F.3d 1268, 1275 (5th Cir. 1994).

have their claims discharged under a conduct test because the introduction of the defective product into the marketplace is what gave rise to a claim.

However, courts utilizing the conduct test often apply it more narrowly and require that the harmed person have been exposed pre-petition to the product or conduct that gives rise to an injury, but not that the injury have manifested pre-petition.<sup>23</sup> The Third Circuit adopted this approach in *JELD-WEN, Inc. v. Van Brunt (In re Grossman's Inc.)*,<sup>24</sup> where it rejected its long-standing adoption of the accrual test from *Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.)*.<sup>25</sup>

In *Grossman's*, the Third Circuit held that the bankruptcy court erred by holding that a plaintiff's asbestos-related tort claims were not discharged, because they had arisen after the effective date of the plan.<sup>26</sup> Twenty years before the company's bankruptcy filing in 1997, the plaintiff purchased products from the company that allegedly contained asbestos.<sup>27</sup> The plaintiff did not file a proof of claim in the bankruptcy case, however, because she was not yet aware of any claim and had not yet manifested any symptoms linked to asbestos exposure. It was not until ten years after the debtors' plan was confirmed that the plaintiff was diagnosed with mesothelioma.<sup>28</sup>

After her diagnosis, she filed, among other things, a tort claim action in state court against the debtors' successor-in-interest, which then sought a determination in bankruptcy court that the asserted claims had been discharged by the debtors' confirmed plan.<sup>29</sup> Agreeing with the plaintiff that the claims were not discharged, the lower courts relied on the *Frenville* accrual test, under which a claim in bankruptcy arose when the underlying state law cause of action accrued (*i.e.*, when the injury manifested).<sup>30</sup> Thus, under *Frenville*, the plaintiff's claims could not have been discharged, as the plaintiff did not manifest symptoms until ten years after plan confirmation.<sup>31</sup> While recognizing that the lower courts properly applied *Frenville*, the Third Circuit stated that the *Frenville* accrual test defined "claim" under the Bankruptcy Code too narrowly. Instead, overruling *Frenville*, the Third Circuit pronounced that, "a 'claim' arises when an individual is exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a 'right to payment' under the Bankruptcy Code."<sup>32</sup>

That the plaintiff had claims under the Bankruptcy Code, however, was not the end of the inquiry on whether such claims were discharged.<sup>33</sup> Whether the plaintiff's claims were discharged turned on whether she was accorded due process. The Third Circuit noted that, "the determination when a claim arises has significant due process implications," because, "[i]f potential future tort claimants have not filed claims because they are unaware of their injuries, they might challenge the effectiveness of any purported notice of the claims bar date."<sup>34</sup> While "Congress took account of the due

23. *In re Grossman's*, 607 F.3d at 125.

24. *Id.*

25. *Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.)*, 744 F.2d 332 (3d Cir. 1984).

26. *In re Grossman's*, 607 F.3d at 118.

27. *Id.* at 117.

28. *Id.*

29. *Id.* at 117–18.

30. *Id.* at 337.

31. *Id.* at 119–20.

32. *Id.* at 125.

33. *Id.*

34. *Id.* at 122.

process implications of discharging future claims of individuals whose injuries were not manifest at the time of the bankruptcy petition” when it enacted section 524(g), the debtors in *Grossman’s* did not utilize the section 524(g) safeguards.<sup>35</sup> The Third Circuit therefore remanded the case to the district court to determine if discharge of the claims would comport with due process.<sup>36</sup>

## 2. Pre-Petition Relationship Test

Under the pre-petition relationship test, the conduct test gets applied only if there was a specific and identifiable relationship pre-petition between the claimant and debtor.<sup>37</sup> Without such a relationship, courts are often concerned with issues concerning adequate notice and due process that could arise.<sup>38</sup> An often-cited example from the Second Circuit articulates the challenges of addressing any future claimant who does not come into contact with the defective product until after the bankruptcy case:

Consider, for example, a company that builds bridges around the world. It can estimate that of 10,000 bridges it builds, one will fail, causing 10 deaths. Having built 10,000 bridges, it becomes insolvent and files a petition in bankruptcy. Is there a “claim” on behalf of the 10 people who will be killed when they drive across the one bridge that will fail someday in the future? If the only test is whether the ultimate right to payment will arise out of the debtor’s pre-petition conduct, the future victims have a “claim.” Yet it must be obvious that enormous practical and perhaps constitutional problems would arise from recognition of such a claim. The potential victims are not only unidentified, but there is no way to identify them. Sheer fortuity will determine who will be on that one bridge when it crashes. What notice is to be given to these potential “claimants”? Or would it suffice to designate a representative for future victims and authorize the representative to negotiate terms of a binding reorganization plan?<sup>39</sup>

This hypothetical inquiry regarding potential future victims and whether they have dischargeable claims was the actual issue before the Court of Appeals for the Eleventh Circuit in *In re Piper Aircraft Corp.*<sup>40</sup> The debtor in *Piper*, a manufacturer and distributor of planes and spare parts, filed for bankruptcy protection after being named in several lawsuits alleging that its aircraft and parts were defective.<sup>41</sup> The debtor pursued a sale of the company, but because it had more than 50,000 planes still in operation, the potential purchaser required that the debtor seek appointment of a legal representative to represent the interests of future claimants so that future product liability claims could be addressed in

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35. *Id.* at 126–27.

36. *Id.* at 127–28.

37. *See Lemelle*, 18 F.3d at 1276 .

38. *See, e.g., In re Grumman*, 467 B.R. at 705; *Cantu v. Schmidt (In re Cantu)*, 784 F.3d 253, 258 (5th Cir. 2015).

39. *In re Chateaugay Corp.*, 944 F.2d 997, 1003 (2d Cir. 1991).

40. *Epstein v. Off. Comm. of Unsecured Creditors of the Est. of Piper Aircraft Corp. (In re Piper Aircraft Corp.)*, 58 F.3d 1573 (11th Cir. 1995), *aff’d* 168 B.R. 434 (S.D. Fla. 1994).

41. *Id.* at 1575.

the bankruptcy.<sup>42</sup> The court appointed an FCR, who filed on behalf of the future claimants a proof of claim that was objected to on the grounds that the future claimants did not have claims under the Bankruptcy Code.<sup>43</sup>

The Eleventh Circuit adopted a pre-petition relationship test and held that the future claimants did not have claims.<sup>44</sup> Under this test, an individual has a claim if “(i) events occurring before confirmation create a relationship, such as contact, exposure, impact, or privity, between the claimant and the debtor’s product; and (ii) the basis for liability is the debtor’s pre-petition conduct in designing, manufacturing and selling the allegedly defective or dangerous product.”<sup>45</sup> Because a pre-confirmation connection between the future claimants and the debtor could not be established, the Eleventh Circuit held that the future claimants did not have claims that could be administered in the bankruptcy case.<sup>46</sup>

The *Piper* test, however, is not precise, as is evident in contexts with latent injuries. Because latent injuries were not an issue in *Piper*,<sup>47</sup> the test did not address whether a party endangered by a defective product pre-petition but having an injury that did not manifest itself until after the bankruptcy has a dischargeable claim. In such cases, the pre-petition relationship test requires more than just the tortious conduct by the debtor and a pre-petition relationship. Because of due process concerns, there at least has to be a general knowledge at the time of the bankruptcy that the debtor’s conduct causes injury.<sup>48</sup>

The cases that consider whether there was a pre-petition relationship between the debtor’s conduct and the claimant illustrate the difficulty in providing due process for future claimants and ensuring a fresh start for the debtor. Absent due process, future claims cannot be discharged through plan confirmation, and debtors face additional litigation and liability.

## B. Was Due Process Afforded to the Future Claimant?

Due process protects an individual from “deprivation of an ‘individual interest that is encompassed within the Fifth and Fourteenth Amendments’ protection of life, liberty, or property” and the absence of procedures that “provide due process of law.”<sup>49</sup> The ability to pursue a legal claim is a protected, cognizable property interest.<sup>50</sup>

Due process generally requires two elements: notice and a hearing.<sup>51</sup> In the bankruptcy context, it is well established that the Due Process Clause requires that a creditor receive adequate notice of the bankruptcy proceeding

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42. *Id.*

43. *Id.*

44. *Id.* at 1577–78.

45. *Id.* at 1577.

46. *Id.* at 1578.

47. *See In re Piper Aircraft Corp.*, 168 B.R. 434, 438 (S.D. Fla. 1994) (“There is absolutely no evidence in the record, nor can the Court conceive of circumstances wherein a prepetition exposure to an allegedly defective Piper aircraft or parts will result in a prepetition injury that does not manifest itself until postpetition.”).

48. *See, e.g., United States Pipe & Foundry Co.*, 577 B.R. 916, 924–25 (Bankr. S.D. Fla. 2017) (holding that toxic tort claims were not discharged because the prepetition tortious conduct was not discovered until after the chapter 11 plan was confirmed).

49. *See In re Energy Future Holdings Corp.*, 949 F.3d 806, 822 (3d Cir. 2020) (quoting *Hill v. Borough of Kutztown*, 455 F.3d 225, 234 (3d Cir. 2006)); *In re Motors Liquidation Co.*, 829 F.3d 135, 158 (2d Cir. 2016).

50. *See In re Energy Future*, 949 F.3d at 822; *In re Motors Liquidation*, 829 F.3d at 158.

51. *Id.*

before it can be bound by a plan of reorganization.<sup>52</sup> If a creditor was not provided adequate notice consistent with due process, then the creditor may be able to successfully pursue its claim years after the debtor purportedly discharged the claim in bankruptcy.

The adequacy of notice must be decided on the unique facts of each case.<sup>53</sup> The type of notice required to satisfy due process depends on whether a creditor is “known” or “unknown.”<sup>54</sup> A known creditor is “one whose identity is either known or ‘reasonably ascertainable by the debtor.’”<sup>55</sup> “Reasonably ascertainable” means the debtor can identify the creditor using “reasonably diligent efforts.”<sup>56</sup> The debtor is not required to exercise “impracticable and extended searches” or to “search out each conceivable or possible creditor and urge that person or entity to make a claim against it”; instead, the search should focus on the debtor’s books and records.<sup>57</sup> Whether the identities of known creditors are reasonably ascertainable must be decided based on the facts of each case.<sup>58</sup>

The debtor must provide a known creditor with actual written notice of the bar date.<sup>59</sup> A defect in issuing actual notice, like an incorrect address, weakens but does not necessarily rebut the presumption that a known creditor has received notice.<sup>60</sup>

In contrast, 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 [the debtor’s] knowledge.’”<sup>61</sup> For unknown creditors, “constructive notice of the claims bar date by publication satisfies the requirements of due process.”<sup>62</sup>

While constructive notice by publication in national newspapers generally is sufficient to satisfy the requirements of due process, the adequacy of notice “depends on the circumstances of a particular case.”<sup>63</sup> The length of

52. See *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999) (noting “the due process principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process” (quoting *Hansberry v. Lee*, 311 U.S. 32, 40 (1940))); *Jones v. Chemetron Corp.*, 212 F.3d 199, 209 (3d Cir. 2000) (“[I]f a potential claimant lacks sufficient notice of a bankruptcy proceeding, due process considerations dictate that his or her claim cannot be discharged by a confirmation order.”); *Morgan Olson L.L.C. v. Frederico (In re Grumman Olson Indus., Inc.)*, 467 B.R. 694, 706 (S.D.N.Y. 2012) (“Courts have held in general that, for due process reasons, a party that did not receive adequate notice of bankruptcy proceedings could not be bound by orders issued during those proceedings.”).

53. See *JELD-WEN, Inc. v. Van Brunt (In re Grossman’s Inc.)*, 607 F.3d 114, 127 (3d Cir. 2010) (*en banc*). To satisfy due process, notice must be “‘reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.’” *Wright*, 679 F.3d at 108 (quoting *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950)).

54. *Wright*, 679 F.3d at 103 n.3

55. *Id.* (quoting *Chemetron Corp. v. Jones*, 72 F.3d 341, 346 (3d Cir. 1995), *cert. denied*, 517 U.S. 1137 (1996)).

56. *Chemetron*, 72 F.3d at 346.

57. *Id.* at 347.

58. *PacifiCorp v. W.R. Grace*, 2006 WL 2375371, at \*8 (D. Del. Aug. 16, 2006).

59. *Wright*, 679 F.3d at 103 n.3.

60. *PacifiCorp*, 2006 WL 2375371, at \*16.

61. *Wright*, 679 F.3d at 103 n.3 (quoting *Chemetron*, 72 F.3d at 346).

62. *Chemetron*, 72 F.3d at 348.

63. *Wright*, 679 F.3d at 108; see also *In re Energy Future Holdings Corp.*, 949 F.3d 806, 822 (3d Cir. 2020) (finding that multi-million-dollar notice program that included publication “in seven consumer magazines, 226 local newspapers, three



time between publication of notice and the confirmation hearing can be a factor in determining whether notice was adequate.<sup>64</sup> Additionally, adequacy of notice turns on what the debtor knew or reasonably could have discovered. Thus, the debtor cannot fraudulently conceal information about claims and use notice as an excuse for discharge.<sup>65</sup>

The difference between known and unknown creditors is significant for understanding the due process concerns for future claimants in a bankruptcy proceeding.<sup>66</sup> “If potential future tort claimants have not filed claims because they are unaware of their injuries, they might challenge the effectiveness of any purported notice of the claims bar date. Discharge of such claims without providing adequate notice raises questions under the Fourteenth Amendment.”<sup>67</sup> In *Grossman*’s, the Third Circuit identified factors relevant to determining whether a bankruptcy confirmation’s discharge of a claim was consistent with due process, where the claim was based on pre-petition conduct that resulted in an injury that manifested years after confirmation. Those factors include:

the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties, including whether it was reasonable or possible for the debtor to establish a trust for future claimants as provided by § 524(g).<sup>68</sup>

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national newspapers, forty-three Spanish-language newspapers, eleven union publications, and five Internet outlets” and resulted in 10,000 proofs of claim filed by latent claimants was consistent with the requirement that unknown claimants are entitled only to publication notice and was constitutionally sufficient).

64. See *In re New Century TRS Holdings, Inc.*, 528 B.R. 251 (D. Del. 2014), *vacated and remanded*, 612 Fed. App’x. 147 (3d Cir. 2015) (finding notice insufficient when published a single time in one national newspaper 39 days before relevant deadline); *Muldrow v. Brookstone, Inc.*, 2015 WL 1523886, at \*3 (D.N.J. Apr. 2, 2015) (“[T]he short period of twenty-six days between notice publication and confirmation hearing in this case may have deprived potential claimants of any realistic opportunity to file claims.”).

65. See *In re Motors Liquidation*, 829 F.3d at 159 (“If a debtor reveals in bankruptcy the claims against it and provides potential claimants notice consistent with due process of law, then the Code affords vast protections. Both § 1141(c) and § 363(f) permit ‘free and clear’ provisions that act as a liability shield. These provisions provide enormous incentives for a struggling company to be forthright. But if a debtor does not reveal claims that it is aware of, then bankruptcy law cannot protect it.”); *In re Geo Specialty Chems. Ltd.*, 577 B.R. 142, 190 (Bankr. D.N.J. 2017) (“[W]hen a party conceals the necessary facts upon which a claim is about to be made, that party cannot benefit from publication by notice. Due process does not allow a debtor who has actively concealed facts necessary to the presentation of certain claims to notify by publication those persons adversely affected by the active concealment.” (quoting *Tillman ex rel. Est. of Tillman v. Camelot Music, Inc.*, 408 F.3d 1300, 1308 (10th Cir. 2005))).

66. See, e.g., *In re UNR Indus. Inc.*, 725 F.2d 1111, 1119 (7th Cir. 1984) (discussing the court’s concern with insuring that future claimants receive “constitutionally adequate notice”).

67. *In re Grossman*’s, 607 F.3d at 122.

68. *Id.* at 127–28. Courts in the Second Circuit consider “whether the party giving notice acted reasonably in selecting means likely to inform persons affected, and most courts hold that ‘for unknown creditors whose identities or claims are not reasonably ascertainable, and for creditors who hold only conceivable, conjectural or speculative claims, constructive notice of the bar date by publication is sufficient’ to satisfy due process.” *Sweeney v. Lafayette Pharmaceuticals, Inc.*, 2020 WL 2079283, at\*3 (D.N.J. Apr. 30, 2020) (quoting *In re Chateaugay Corp. Reomar, Inc.*, 2009 WL 367490, at \*5 (Bankr. S.D.N.Y. Jan. 14, 2009)).

While publication notice to unknown creditors weighs in favor of finding that discharge comports with due process,<sup>69</sup> it is uncertain whether publication notice is adequate for claimants with latent injuries.<sup>70</sup> Notably, such due process concerns are not implicated when a debtor utilizes section 524(g) of the Bankruptcy Code.<sup>71</sup>

### C. Future Claimants Need Independent Representation to Protect Their Due Process Rights

As described above, by virtue of their status as unknown claimants and the latent nature of their injuries, it is difficult to provide future claimants with adequate notice.<sup>72</sup> Not only can the liable party not identify the future claimants to be given actual notice, but the future claimants may be incapable of understanding the implications of any notice and thus appreciating that they have a claim to pursue.<sup>73</sup> Without effective notice, future claimants are unable to represent, and be heard on, their own interests.

No other constituency in a bankruptcy case adequately represents future claimants, because no other party's interests fully align with future claimants' interests on all issues.<sup>74</sup> The conflict with official committees that represent current claimants exists to the extent that current and future claimants are competing for compensation from a limited

69. See *Davis v. Grubb*, 2013 WL 2297185, at \*8 (E.D. Pa. May 23, 2013) (finding that publication of the bankruptcy in *USA Today* notified unknown claimants and complied with due process).

70. See *Sweeney v. Alcon Labs.*, 856 Fed. App'x. 371, 375–76 (3d Cir. 2021) (not precedential), *cert. denied sub nom.* *Sweeney v. Eastman Kodak Co.*, 142 S. Ct. 565 (2021) (holding that publication to unknown non-asbestos latent claimant was sufficient to discharge claims but noting that claimant did not make argument that publication notice was not enough because the claims were not only unknown to the debtor but also the creditor); *In re Energy Future Holdings Corp.*, 949 F.3d 806, 822 (3d Cir. 2020) (recognizing that latent claimants may be able to have claims reinstated because of lack of due process pursuant to Bankruptcy Rule 3003 even though debtors launched multimillion-dollar notice plan that included publication notice); *Williams v. Placid Oil Co.* (*In re Placid Oil Co.*), 753 F.3d 151, 157–58 (5th Cir. 2014) (holding that asbestos claims were discharged because publication of bar date in newspaper of national circulation satisfied due process); *Wright v. Owens Corning*, 679 F.3d. 101, 108–09 (3d Cir. 2012) (stating that due process was not afforded in a non-524(g) case by publication notice to asbestos claimants who did not understand at the time of the notice that they held claims); *Jones v. Chemetron Corp.*, 212 F.3d 199, 210 (3d Cir. 2000) (holding that a claim of a yet-to-be-born claimant who was incapable of receiving notice when it was issued was not discharged); *In re RailWorks Corp.*, 621 B.R. 635, 653–54 (Bankr. D. Md. 2020) (holding that publication in national edition of *Wall Street Journal* was sufficient to provide notice to unknown asbestos claimants).

71. See *In re W.R. Grace & Co.*, 729 F.3d 311, 323–24 (“As we explained in *Combustion Engineering*, and again in *Grossman*’s, § 524(g) includes a number of requirements that ‘are specifically tailored to protect the due process rights of future claimants,’ such as the ‘fair and equitable’ provision and the mandatory seventy-five percent approval requirement. Therefore, as long as a court correctly determines that § 524(g)’s requirements are satisfied, present and future claims can be channeled to a § 524(g) trust without violating due process.”) (internal citations omitted).

72. See *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 628 (1997) (recognizing the difficulties of providing adequate notice to future asbestos claimants); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 844 (1999) (same).

73. See *In re Placid Oil Co.*, 753 F.3d 151, 164 (5th Cir. 2014) (Dennis, J., dissenting) (noting that unknown future claimant was “functionally incompetent” to receive notice because she was unable to recognize the effect of notice on her rights when no injury had manifested). The latency problem of asbestos is exacerbated by the fact that some victims may have been exposed unknowingly and indirectly, such as by laundering the clothes of a family member who was occupationally exposed to asbestos. See *In re Placid Oil*, 753 F.3d at 153 (majority).

74. See *Ortiz*, 527 U.S. at 856 (noting inherent conflict between current and future claimants giving rise to need for separate representation); *In re UNR Indus., Inc.*, 46 B.R. 671, 675 (Bankr. N.D. Ill. 1985) (stating that future claimants not adequately represented by current claimants); *In re Johns-Manville Corp.*, 36 B.R. 743, 749 (Bankr. S.D.N.Y. 1984) (same).

fund.<sup>75</sup> If future claimants do not have their own representation in a bankruptcy case, there is a high risk they will receive less favorable treatment than current claimants will attain.<sup>76</sup> Because a claim can be discharged through bankruptcy only if the claimant received adequate notice, future claimants present a distinct issue for companies seeking to resolve mass tort liabilities through a reorganization. The use of an FCR in asbestos cases under section 524(g) of the Bankruptcy Code is a statutorily sanctioned solution to this due process concern for future claimants that also can be and has been a model for other mass tort cases to provide debtors with greater certainty regarding their ability to remain going concerns.<sup>77</sup>

## II. ESTABLISHMENT OF THE FCR'S ROLE TO PROTECT FUTURE CLAIMANTS' INTERESTS

An FCR may be appointed to represent the interests of the currently unidentifiable personal injury victims who may seek compensation for their injuries after a plan of reorganization is confirmed. Appointing an FCR is typically the most effective mechanism utilized to address future claims consistent with due process.<sup>78</sup> The FCR does not, however, represent any persons who have or could have asserted a claim prior to plan confirmation. Nor does the FCR represent any known individuals, because to do so would create a conflict of interest.<sup>79</sup>

As a general matter, the FCR advocates for the future claimants' rights by participating in proceedings and overseeing the notice process for unknown claimants. Moreover, the FCR's participation in proceedings usually suffices to vicariously satisfy the due process requirement to provide a claimant an opportunity to be heard. Appointing an FCR emerged as a solution to the due process challenges associated with future claimants in asbestos cases in the *Manville* and *UNR* bankruptcies, and eventually was codified by Congress through the enactment of section 524(g) of the Bankruptcy Code in 1994. This historical development of the FCR will be discussed below.<sup>80</sup>

### A. Asbestos Bankruptcy Cases Form the Model for Resolving Future Claims While Protecting the Due Process Interests of Future Claimants

In the early 1980s, two companies with asbestos liabilities used bankruptcy proceedings to reorganize and channel their asbestos liability to settlement trusts for resolution. Their early experience demonstrates not only the potential and challenges of the FCR model, but also the uncertainty that remained for reorganizing debtors before Congress enacted section 524(g).

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75. See *Georgine v. Amchem Prods. Inc.*, 83 F.3d 610, 630–31 (3d Cir. 1996) (recognizing that the inherent conflict between existing claimants who desire immediate, unlimited recovery and latent claimants who desire that recovery be capped or delayed to ensure that existing claimants will not deplete funds precludes the use of one representative for both groups), *aff'd sub nom.* *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997).

76. See *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 242 (3d Cir. 2005) (finding that future claimants received “demonstrably unequal” treatment under deal struck before FCR was appointed).

77. See *Sweeney v. Alcon Labs.*, 856 Fed. App'x. 371, 375 n.7 (3d Cir. 2021) (recognizing that, in non-asbestos case with latent injuries, creation of trust and appointment of a future claims representative may be warranted).

78. See *Miller v. Chrysler Grp., LLC*, 2012 WL 6093836, at \*4 (D.N.J. Dec. 7, 2012). Likewise, due process may be satisfied where a committee has represented the claims and ensured certain rights were preserved to them. See *id.*

79. See *In re UNR Indus., Inc.*, 71 B.R. 467, 479–80 (Bankr. N.D. Ill. 1987).

80. Again, while the application of section 524(g) itself is limited to asbestos, the policy and framework of section 524(g) are applicable to other mass torts.

## 1. The *Manville* Bankruptcy Case

### a. Early Proceedings Led to the Appointment of an FCR

The bankruptcy of Johns-Manville Corp. and its affiliated companies (collectively, “Manville”), among the largest suppliers of asbestos products, was the first to involve the appointment of an FCR.<sup>81</sup> On August 26, 1982, facing lawsuits arising from approximately 16,500 asbestos-related deaths and injuries, Manville filed a voluntary petition for reorganization under chapter 11 of the Bankruptcy Code.<sup>82</sup>

A co-defendant of Manville filed a motion seeking appointment of a legal representative for future claimants.<sup>83</sup> The court noted that it was “abundantly clear” that the case had to address future claimants to safeguard their “compelling interest.”<sup>84</sup> The court defined “future asbestos claimants” to include “all persons or entities who, on or before August 26, 1982 [the petition date], came into contact with asbestos or asbestos-containing products mined, fabricated, manufactured, supplied or sold by Manville and who have not yet filed claims against Manville for personal injuries or property damage.”<sup>85</sup> The court noted these persons, “may be unaware of their entitlement to recourse against Manville due to the latency period of many years characterizing manifestation of all asbestos related diseases.”<sup>86</sup>

The court based on three factors its conclusion that future claimants had “at the very least a cognizable interest in this reorganization” sufficient to be considered parties in interest entitled to appear and be heard under section 1109(b) of the Bankruptcy Code. First, the statistical data on the likely numbers and values of future claims against Manville demonstrated that, as a practical matter, any plan that did not address the interests of future claimants would not serve the interests of the debtors or creditors, because Manville would be forced back into bankruptcy.<sup>87</sup> Second, section 1109(b) was broad enough to “embrace the interests of future claimants as affected parties.”<sup>88</sup> Future claimants were “undeniably parties in interest” who required a representative, separate and distinct from the existing committees in the case, to give those claimants a voice in formulating the plan.<sup>89</sup> Third, because case law demonstrated that mere exposure to asbestos can trigger insurance coverage, the court concluded that that same exposure justified a determination that future claimants were parties in interest in the bankruptcy case.<sup>90</sup> The court reserved decision on the question of whether future claims were dischargeable.<sup>91</sup> But the “unprecedented, extraordinary nature of” Manville’s

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81. See *In re Johns-Manville Corp.*, 36 B.R. 743 (Bankr. S.D.N.Y. 1984).

82. See *In re Joint E. & S. Dists. Asbestos Litig.*, 129 B.R. 710, 751 (E.D.N.Y. & S.D.N.Y. 1991), *vacated on other grounds*, 982 F.2d 721 (1992), *modified*, 993 F.2d 7 (2d Cir. 1993).

83. *In re Johns-Manville Corp.*, 36 B.R. at 744.

84. *Id.*

85. *Id.* at 744–45.

86. *Id.* at 745.

87. *Id.* at 746.

88. *Id.* at 748–49.

89. *Id.* at 749.

90. *Id.*

91. *Id.* at 754.

bankruptcy cases required that future claimants have a legal representative “to act independently and impartially where appropriate in the case,” which was important in the development of a plan and claims estimation procedures.<sup>92</sup>

The exact terms and role of the FCR were left for later determination, but the court suggested the role could be based on other forms of legal representation, like guardian ad litem, amicus curiae, and examiner.<sup>93</sup> The court cited its equitable powers, including under section 105(a) of the Bankruptcy Code, in making the appointment.<sup>94</sup> The *Manville* court suggested that every court has inherent power to appoint a representative for unknown parties in interest.<sup>95</sup>

Later, the bankruptcy court appointed an FCR and redefined future claimants as persons who “have been exposed to asbestos or asbestos products mined, manufactured or supplied by Manville [pre-petition] and have manifested or will manifest disease post-petition and who are not otherwise represented in these proceedings.”<sup>96</sup> The FCR was given the same powers and duties as a committee under section 1103 of the Bankruptcy Code, subject to reduction or enlargement by the bankruptcy court.<sup>97</sup> On appeal by two committees and a putative future claimant who challenged the FCR’s appointment, the district court affirmed, stating that providing the FCR with powers similar to those of a committee ensured that the future claimants “will have a meaningful opportunity to be heard and to participate.”<sup>98</sup> Likewise, compensating the FCR from the estate was “wholly appropriate” in light of the importance of having adequate representation for future claimants.<sup>99</sup>

In 1986, the bankruptcy court issued orders (the “1986 Orders”) confirming Manville’s plan of reorganization, which implemented three unique features: (i) appointment of a legal representative for future claimants (an FCR); (ii) establishment of a claims resolution trust with funds to satisfy future claims; and (iii) issuance of a channeling injunction, which required future claimants to seek satisfaction of their claims from the trust.<sup>100</sup>

In so doing, the court overruled objections that the plan violated the due process rights of future claimants.<sup>101</sup> The court noted that due process “does not and has never, mandated personal, actual notice” but instead “requires notice ‘reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.’”<sup>102</sup> The debtor’s notice plan “was designed to inform as many future asbestos claimants as possible . . . and give them a voice in these proceedings.”<sup>103</sup> In addition, the FCR, who was active in the case, became “the catalyst for, if not the architect of[,]” the plan and was endowed with rights and duties available

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92. *Id.* at 757.

93. *Id.* at 758–59.

94. *Id.* at 758.

95. *Id.*

96. *Robinson v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 52 B.R. 940, 942 (S.D.N.Y. 1985).

97. *Id.*

98. *Id.* at 942, 944.

99. *Id.* at 944.

100. The Bogdan Law Firm *ex rel.* Parra v. Marsh USA, Inc. (*In re Johns-Manville Corp.*), 319 F. Supp. 3d 633, 636 (S.D.N.Y. 2018), *rev’d*, 802 F. App’x 20 (2d Cir. 2020).

101. *In re Johns-Manville Corp.*, 68 B.R. 618 (Bankr. S.D.N.Y. 1986).

102. *Id.* at 626 (quoting *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950)).

103. *Id.* (stating that the noticing plan included national television and radio advertisements and newspaper advertisements in six U.S. and Canadian papers and the largest circulated daily paper in each state).

to an official committee.<sup>104</sup> The court chastised the objectors, pointing out that the “impossible version of due process” they requested would effectively destroy—instead of preserve—the rights and remedies of future claimants.<sup>105</sup> The court also noted that it need not determine whether the future claimants held cognizable claims because their claims would not be discharged but instead would be funneled by the injunction to the same trust as the present claims.<sup>106</sup>

### **b. Later Proceedings Explored Whether the FCR Had Represented Certain Types of Claims Against Manville’s Insurers**

Manville’s litigation experience after reorganizing demonstrates the significant role of an FCR in determining whether a future claimant was accorded due process and the future claim was discharged in bankruptcy. This is evident from the divergent outcomes for the parties in the cases discussed below. On one hand, a non-settling insurer was found not to have been represented by the FCR during the bankruptcy proceeding, and therefore, its claims were not discharged because it did not receive due process. On the other hand, because the FCR represented future asbestos victims, an individual claimant was found to have been accorded due process, and therefore, his claim was found to have been discharged during the bankruptcy proceeding.

The *Manville* settlement trust faced financial trouble soon after it was established. As a result, plaintiffs began to sue Manville’s insurers for allegedly independent torts in order to avoid the channeling injunction. The insurers then sought to have the channeling injunction enforced to bar such suits.<sup>107</sup> That litigation led to Manville’s principal insurer reaching a settlement in 2003 to pay additional amounts into a separate fund, conditioned on a ruling that the claims were covered by the 1986 Orders.<sup>108</sup> Over the FCR’s objection, the bankruptcy court issued that clarification.<sup>109</sup>

A non-settling insurer appealed this decision and sought to preserve its right to pursue contribution and indemnity claims against a settling insurer.<sup>110</sup> On appeal, the Supreme Court held that the 1986 Orders had become final and challenges to them were barred by issue preclusion.<sup>111</sup> The Supreme Court further held that the 1986 Orders channeled even non-derivative claims against insurers that were based on their coverage of Manville, but parties that did not receive due process leading up to the 1986 Orders were not precluded from challenging the bankruptcy court’s jurisdiction.<sup>112</sup>

On remand, the Second Circuit concluded that the non-settling insurer’s claims were *in personam* and not channeled to the trust.<sup>113</sup> Looking to due process principles applied in class action settlements, the court found the non-settling insurer, Chubb, had not been adequately represented in the 1986 proceedings as the FCR represented asbestos

104. *Id.* at 626–27.

105. *Id.* at 627.

106. *Id.* at 628.

107. *In re Johns-Manville Corp.*, 319 F. Supp. 3d 633, 637 (S.D.N.Y. 2018), *rev’d*, 802 F. App’x 20 (2d Cir. 2020).

108. *Id.* at 636–37.

109. *Id.*

110. *Id.* at 637.

111. *Id.*

112. *Id.*

113. *Id.*

victims and not insurers, and the non-settling insurer had not received adequate notice because it could not have foreseen that the bankruptcy court overstepped its jurisdiction.<sup>114</sup>

In a subsequent case, *The Bogdan Law Firm ex rel. Parra v. Marsh USA, Inc.*, an individual claimant sued Manville's primary insurance broker in state court, alleging that the broker knew of the dangers of asbestos and conspired with Manville and others to prevent that information from being disclosed.<sup>115</sup> The broker filed a motion to enforce the 1986 Orders against the individual claimant.<sup>116</sup> The bankruptcy court held the claims were barred, and the district court affirmed but remanded to develop the record as to whether the FCR had provided adequate representation of the claim to satisfy due process.<sup>117</sup> On remand, the bankruptcy court found the FCR had provided adequate representation consistent with due process.<sup>118</sup> In addition, as directed by the district court, the bankruptcy court considered whether denial of due process would have prejudiced the claimant and concluded there would have been no prejudice, because the claimant was able to file a claim with the *Manville* trust.<sup>119</sup>

On a second appeal, the district court disagreed with both of the bankruptcy court's findings on remand. First, the district court held that because the claims brought by the individual claimant were outside of the bankruptcy court's jurisdiction in 1986, the FCR could not have represented them at all, let alone adequately.<sup>120</sup> Second, the district court found that the FCR did not provide adequate representation of the individual's claims because no one believed the bankruptcy could bind future claimants with respect to non-derivative claims against third parties, and the FCR may have advocated differently had he thought he represented such claims.<sup>121</sup>

In the subsequent appeal to the Second Circuit, the parties disagreed whether the claimant had received sufficient due process during the 1986 bankruptcy proceedings to bind him to the 1986 Orders.<sup>122</sup> In issue was whether the FCR had represented all potential *in personam* actions, and not just *in rem* actions, that the future claimants may have had against the settling insurers and insurance brokers.<sup>123</sup>

The Second Circuit noted that, in 1985 and later, the FCR had argued in written pleadings and at hearings that the 1986 Orders should apply only to *in rem* claims.<sup>124</sup> The FCR did so because he believed the bankruptcy court lacked jurisdiction to issue an order channeling *in personam* claims.<sup>125</sup> While the FCR's argument was not ultimately successful, the fact that he had advocated for future claimants with respect to potential *in personam* claims supported the conclusion that the FCR had provided the individual claimant with adequate representation.<sup>126</sup>

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114. *Id.*

115. *Id.*

116. *Id.* at 638.

117. *Id.*

118. *Id.*

119. *Id.* at 642–43.

120. *Id.* at 641–42.

121. *Id.* at 643.

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* at 24.

126. *Id.*

Reversing the district court, the Second Circuit reinstated the bankruptcy court's ruling that the individual's claim against the broker was barred due to the FCR's representation. The Second Circuit concluded that the claimant had received constitutionally sufficient notice based on the circumstances of the *Manville* case.<sup>127</sup> Those circumstances included the appointment of the FCR, as well as a publicity campaign designed to reach as many future asbestos claimants as possible, including through national television, radio, and newspaper advertisements.<sup>128</sup> The Second Circuit declined to opine as to what notice would be required under other circumstances, including if a potential claimant was not represented by an FCR.<sup>129</sup>

## 2. The *UNR* Bankruptcy Case

UNR Industries, Inc. and certain affiliates (collectively, "UNR"), facing thousands of asbestos-claim lawsuits, filed for bankruptcy protection in 1982.<sup>130</sup> The court recognized that if future claimants were not bound by the bankruptcy orders, the reorganized debtor would be subject to eventual financial devastation caused by future asbestos liabilities, and that any meaningful plan of reorganization therefore needed to account for future claimants. UNR's reorganization plan relied on the same principles as those established in *Manville*: the creation of a trust, the issuance of an injunction prohibiting claimants from suing UNR or the insurers, and the appointment of a legal representative for future asbestos claimants.

### a. Early Proceedings Debated the Necessity of an FCR

In an effort to account for future claims, UNR petitioned the bankruptcy court to appoint a representative to participate, on behalf of its unknown future claimants, in the negotiation of a plan to resolve all the asbestos claims against UNR.<sup>131</sup> The district court had declined to appoint a representative on the basis that uninjured persons did not have claims to address in the bankruptcy case.<sup>132</sup> But the Seventh Circuit suggested that such persons may be able to file claims in the bankruptcy case because the bankruptcy court had equitable powers potentially broad enough to provide for future claims in confirming a plan. The Seventh Circuit nonetheless expressed no opinion on whether future claimants could be represented in the case similarly to how they are represented in class actions.<sup>133</sup>

Thirteen months later, no putative future claimants had requested the appointment of an FCR.<sup>134</sup> The debtors filed a motion for reconsideration of the district court's refusal to appoint an FCR, to which the district court responded by authorizing the bankruptcy court to address the motion.<sup>135</sup>

While the Seventh Circuit had left open whether putative future claimants were creditors entitled to assert claims against UNR, the bankruptcy court concluded that the question need not bar the appointment of an FCR for the

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127. *Id.*

128. *Id.*

129. *Id.* at 25.

130. *In re UNR Indus., Inc.*, 725 F.2d 1111, 1113 (7th Cir. 1984).

131. *Id.*

132. *Id.* at 1114.

133. *Id.* at 1119.

134. *In re UNR Indus., Inc.*, 46 B.R. 671, 674 (Bankr. N.D. Ill. 1985).

135. *Id.*



interests of such claimants.<sup>136</sup> Citing its powers in equity and the flexibility of the Bankruptcy Code, the bankruptcy court agreed with the *Manville* court that future, “[p]utative asbestos disease victims have a stake in the outcome of these proceedings, which entitles them to party-in-interest status.”<sup>137</sup> The bankruptcy court found that the circumstances of the case warranted appointment of an FCR because the putative victims were not representing themselves, nor was anyone else, and the proceedings had reached such an advanced stage that an FCR was needed to “act as *amicus curiae* regarding matters of vital and immediate importance to these people.”<sup>138</sup>

Seemingly under the belief—shared by the Seventh Circuit—that the putative victims were identifiable, the bankruptcy court delineated the “primary task” of the FCR as “to advise putative asbestos disease victims of the pendency of and their interest in these bankruptcy proceedings.”<sup>139</sup> Further, the court directed that the FCR could be heard with respect to any proposed plan of reorganization or a motion to convert the case, must seek leave of court to get involved in any other litigation in the case, but otherwise “shall exercise the powers and responsibilities of an official creditors’ committee as set forth in section 1103 of the Bankruptcy Code.”<sup>140</sup>

The court stated that its decision to appoint an FCR was intended to remove the economic barrier for putative victims to participate in the case, but it left for another day the question of those victims’ larger rights:

The determination of whether putative asbestos disease victims are creditors of these estates, or whether their interests could be represented in these proceedings in a manner analogous to a class action, or whether these parties would be entitled to vote on a plan of reorganization, or whether their claims might be discharged in this bankruptcy proceeding, are all questions which can properly be addressed after putative asbestos disease victims commence actual participation in these cases.<sup>141</sup>

## b. Later Proceedings Defined the Scope of the FCR’s Representation

A later decision further refined the scope of the FCR’s representation, making it clear that the FCR did not represent individual future claimants.<sup>142</sup> Two persons claiming to be putative asbestos victims filed proofs of claim based on possible future injuries they may develop from asbestos exposure.<sup>143</sup> The debtors objected and asked the court to direct the FCR to represent and assist the two claimants, who were unable to afford counsel.<sup>144</sup> The FCR, the committee of present claimants, and the U.S. Trustee opposed the request.<sup>145</sup>

The *UNR* court observed that, because the case was likely to result in a confirmed plan that would establish a trust to provide payment to future claimants when they became sick, the FCR would not be required to take a position

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136. *Id.*

137. *Id.* at 675.

138. *Id.*

139. *Id.*

140. *Id.* at 675–76.

141. *Id.* at 676.

142. *In re UNR Indus., Inc.*, 71 B.R. 467, 472 (Bankr. N.D. Ill. 1987).

143. *Id.* at 469.

144. *Id.*

145. *Id.*

on whether future claimants were creditors.<sup>146</sup> The debtors, however, wanted the question resolved so that the reorganized debtor was protected because future claimants would be bound by the plan's discharge.<sup>147</sup> Thus, the debtors encouraged the two putative claimants to file claims and then objected to such claims.<sup>148</sup>

The FCR argued that his appointment order prohibited him from representing individual claimants, just as a person representing a committee cannot represent another entity in the same case.<sup>149</sup> While the appointment order gave the FCR powers similar to those of a committee, the FCR was not a committee, and his powers and responsibilities were prescribed and could be altered by the court.<sup>150</sup> The court agreed with the FCR, concluding that:

The Legal Representative represents future claimants, *i.e.*, those people who have been exposed to asbestos, who have not yet shown any signs of asbestos-related disease, but who in fact will eventually suffer asbestos-related disease in the future as a result of their exposure to UNR's product. The reason for this conclusion is clear. It is the future claimants who need the Legal Representative's protection. The putative claimants, *i.e.*, all those who have been exposed to UNR's asbestos but have yet to get sick as a result of that exposure, will only be entitled to damages from UNR if and when they contract an asbestos-related disease. It is hard to see what claim those who were exposed to UNR's product but who never will suffer an asbestos-related injury as a result have against UNR or its assets now or at any time in the future.<sup>151</sup>

While *Manville* and *UNR* cleared the path to appointment of an FCR, much uncertainty remained as to when an FCR was required, what role the FCR should play, and how to define future claimants.<sup>152</sup> The congressional enactment of section 524(g) of the Bankruptcy Code in 1994 sought to provide more certainty to debtors, as well as existing and future claimants, in asbestos bankruptcy cases.

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146. *Id.*

147. *Id.* at 473–74.

148. *Id.*

149. *Id.* at 478.

150. *Id.* at 478–79.

151. *Id.* at 479 (internal citation omitted).

152. See *In re Amatek Corp.*, 755 F.2d 1034, 1042–44 (3d Cir. 1985) (finding that regardless of whether future claimants had cognizable claims in the bankruptcy case, “such individuals clearly have a practical stake in the outcome of the proceedings” and were deserving of their own spokesperson); *Locks v. U.S. Trustee*, 157 B.R. 89, 94 (W.D. Pa. 1993) (finding that current claimant’s representative is not proper party to seek FCR appointment); *In re Eagle-Picher Industries, Inc.*, 144 B.R. 69 (Bankr. S.D. Ohio 1992) (addressing scope of future claimants).

## B. The Enactment of Section 524(g) of the Bankruptcy Code to Expressly Protect Future Claimants in Asbestos Cases

In 1994, Congress codified in section 524(g) of the Bankruptcy Code the model adopted in *Manville* and *UNR* for addressing future claims, confirming the propriety of the structure used in those cases and making it available for other debtors facing asbestos-related liabilities.<sup>153</sup> While section 524(g) is not a panacea, the Third Circuit has described it as “perhaps the best vehicle for addressing” due process rights of future claimants.<sup>154</sup>

### 1. Section 524(g) Channels Future Claims

Under section 524(g), the court issues an injunction that prohibits actions against certain protected parties for claims or demands<sup>155</sup> that are “to be paid in whole or in part by a trust.”<sup>156</sup> The injunction will be “valid and enforceable,” and no successor or transferee of the debtor’s assets is liable for a claim or demand against the debtor if certain criteria are met. Establishment of the trust is high among those criteria. In addition to meeting other funding requirements, the trust assumes the liabilities of a debtor that has been named as a defendant of personal injury, wrongful death, or property-damage claims based on exposure to asbestos.<sup>157</sup> In issuing the injunction, the court must make certain findings with respect to future demands, voting on the plan, and the proposed payment mechanism.<sup>158</sup> The channeling injunction can “include any right to or demand for payment that arises from the debtor’s underlying asbestos liabilities, regardless of when that right or demand arises, whether it was raised during the bankruptcy proceeding or is contingent on a future event.”<sup>159</sup>

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153. See H.R. REP. NO. 103-835 (1994); *In re Fairbanks Co.*, 601 B.R. 831, 837 (Bankr. N.D. Ga. 2019) (“The legislative history of § 524(g) shows that Congress intended § 524(g) to ‘offer similar certitude to other asbestos trust-injunction mechanisms that meet the same kind of high standards with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases [*Johns-Manville* and *UNR Industries*].’” (quoting H.R. REP. NO. 103-835, at 40 (1994))).

154. *In re Energy Future Holdings Corp.*, 949 F.3d 806, 812–13 (3d Cir. 2020). In *In re Energy Future*, where the debtors eschewed using section 524(g) and instead chose to set a bar date that covered latent claims, the Third Circuit Court of Appeals lamented that decision as a “cautionary tale for debtors attempting to circumvent § 524(g)” because of its adverse impact on claimants and substantial use of resources for notice and back-end litigation. *Id.* at 825.

155. What we colloquially call “future claims,” the statute defines as “demands,” meaning “a demand for payment, present or future, that . . . was not a claim during the proceedings leading to the confirmation” of the plan, arises out of the same conduct or events as the other claims addressed by the injunction, and is to be paid by the trust. See 11 U.S.C. § 524(g)(5).

156. 11 U.S.C. § 524(g)(1)(B).

157. 11 U.S.C. § 524(g)(2)(B).

158. See 11 U.S.C. § 524(g)(2)(B)(ii) (requiring the consideration of whether (1) the debtor is likely to be subject to substantial future demands for the same conduct or events addressed in the injunction; (2) “the actual amounts, numbers, and timing of such future demands cannot be determined”; (3) pursuit of demands aside from the structure established by the plan threatens the plan’s ability to equitably address claims and future demands; (4) the current claimants are in a separate class and vote by at least 75 percent of those voting in favor of the plan; and (5) the trust will have mechanisms that “provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner”).

159. *In re W.R. Grace & Co.*, 729 F.3d 311, 321 (3d Cir. 2013).

Section 524(g) strives to ensure fair treatment for future claims.<sup>160</sup> As a result, there are two specific requirements to protect future claimants. First, the statute requires appointment of an FCR for the purposes of protecting future claimants' rights.<sup>161</sup> Second, the court must determine that the identification of the debtor and other persons to be protected by the injunction "is fair and equitable" with respect to future claimants in light of the benefits provided by the trust on behalf of the protected persons.<sup>162</sup>

## 2. Section 524(g) Provides for, but Does Not Delineate, the Role of an FCR

The statute requires the appointment of an FCR but does not delineate how the FCR carries out that role.<sup>163</sup> Nonetheless, the statute provides guidance in that it directs the court to make certain determinations before issuing an injunction under section 524(g).<sup>164</sup>

Section 524(g) expressly contemplates that a trust will be established to pay claims, but for the trust to protect future claimants, there needs to be a level of certainty that it will be a source of compensation for the future claimants.<sup>165</sup> As the future claimants' fiduciary who must be appointed in the proceedings leading to the injunction,<sup>166</sup> the FCR has an inherent role to ensure that there is factual support for the court to make the required determinations and to ensure that the injunction and trust (including its funding) are fair to the future claimants.<sup>167</sup>

160. *Id.* at 323 ("Congress wanted to cover the whole set, and it did. The distinction, to the extent there is one, between a 'claim' and a 'demand' is therefore unimportant to the scope of the channeling injunction; the relevant question is instead whether an action seeks recovery that stems from the debtor's asbestos-related liabilities. If it does, then it falls somewhere within the broad category of 'any claim or demand,' and can be subject to a channeling injunction."); *In re Flintkote Co.*, 486 B.R. 99, 127 (Bankr. D. Del. 2012) ("Whether referred to as 'future demand holders' or 'future claimants,' the bottom line is that without a channeling injunction in place and an FCR appointed to protect their interests, by the time their injuries manifest there will be a high probability that the debtor will lack funds to provide them with just compensation.").

161. 11 U.S.C. § 524(g)(4)(B)(i).

162. 11 U.S.C. § 524(g)(4)(B)(ii).

163. The statute does not expressly identify a role for the FCR after the injunction issues, but it is common practice for the trust to include an FCR role and for the person who was the FCR in the bankruptcy case to continue in that position post-confirmation. This is fully consistent with the purposes of section 524(g) in that the FCR balances the role of the trust advisory committee, which represents current claimants, in ensuring that the protections approved as part of the bankruptcy case are maintained in a manner that continues to provide the necessary assurances of fair and equitable treatment for future claimants. Section 524(g) also is silent as to the process for appointing an FCR. *See, e.g.,* *Vara v. Duro Dyne Nat'l Corp. (In re Duro Dyne Nat'l Corp.)*, 2019 WL 4745879 (D.N.J. Sept. 30, 2019); *In re Fairbanks Co.*, 601 B.R. 831, 838 (Bankr. N.D. Ga. 2019).

164. *See supra* note 158 and accompanying text for a description of the findings required to issue an injunction under section 524(g).

165. *See In re W.R. Grace & Co.*, 729 F.3d 332, 343 (3d Cir. 2013).

166. An FCR can be appointed to address personal injury claims or property damage claims. *Id.* at 341.

167. *See id.* at 330 ("[O]ne way to evaluate the equities is to consider the amount being contributed to the trust in comparison to the liability exposure of the protected parties"); *In re Plant Insulation Co.*, 734 F.3d 900 (9th Cir. 2013), *cert. denied*, 572 U.S. 1062 (2014) ("[B]efore it may issue an injunction under § 524(g), a court must ensure that the remedy [will] be 'fair and equitable' to future asbestos plaintiffs (the parties to be enjoined) when viewed in comparison to the benefits provided by the bankrupt and its insurers (the parties to be benefitted by the injunction)."; *see also In re Fairbanks*, 601 B.R. at 838–39 ("Section 524(g)(4)(B)(ii) requires the Court to determine that a channeling injunction under a plan is 'fair and equitable' with regard to future claimants before confirming it. Because confirmation of a plan and issuance of a channeling injunction depend on compliance with this standard, the terms of both are necessarily a subject of negotiation and litigation in which the FCR must advocate the interests of

To carry out that role, the FCR must conduct appropriate diligence on the debtor's asbestos liabilities, the parties to be protected by the injunction, and the assets available to fund the trust, as well as be involved in the negotiation of the documents that will govern the trust and set forth the mechanisms for how present and future claims will be treated.<sup>168</sup> The FCR has a fiduciary obligation to represent the interests of future claimants, but that duty extends only to legitimate future claimants, whose claims are based on reliable evidence and not on fraudulent evidence or no evidence at all.<sup>169</sup>

Section 524(g) confers upon an FCR the power to veto the issuance of a channeling injunction. Although when read in isolation, section 524(g) does not explicitly provide for this veto power, sections 524(g) and (h), taken together, condition the enforceability of a channeling injunction upon the FCR's consent to the confirmation of any plan that contains such an injunction.<sup>170</sup> Absent the power to block the injunction, the FCR would be assigned the constitutionally mandated task of protecting the due process rights of unknown future claimants but would be denied any authority by which to accomplish this task. Indeed, if future claimants each could somehow have their own vote in an asbestos debtor's bankruptcy proceeding, given their superior numbers in most cases, no plan that imposed a channeling injunction could be approved in the face of their opposition. The FCR, as the proxy for all future claimants in this matter, is similarly empowered.

Congress originally enacted section 524(g) to provide the bankruptcy courts with a mechanism to manage asbestos liability during a reorganization and allow debtors to emerge having addressed potential future claims in a meaningful way. Enactment of section 524(h) also confirmed the propriety of the *Manville* and *UNR* models of reorganization, which relied on an FCR, a channeling injunction, and a settlement trust. This certainty for debtors is important to those companies facing mass tort liability beyond the asbestos context. As described in Section IV, other means to address these kinds of future claims have not provided the same level of certainty.

### C. Courts Have Defined the Duties and Scope of the FCR

The role of the FCR has developed over time, and the scope of the role continues to be refined by the courts. While section 524(g) requires the appointment of an FCR "as part of the proceedings leading to issuance of [the]

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future claimants. The 'fair and equitable' statutory language is meaningful only if the FCR is an objective and effective advocate for the unknown claimants whose interests the statute protects. Limiting a court's consideration of the appointment of an FCR to whether the candidate is 'disinterested' and facially qualified ignores the statutory purpose of the FCR, which is to provide an effective advocate for otherwise unrepresented future claimants."); *In re Pittsburgh Corning Corp.*, 2013 WL 2299620, at \*21 (Bankr. W.D. Pa. May 24, 2013), *aff'd*, *Mt. McKinley Ins. Co. v. Pittsburgh Corning Corp.*, 518 B.R. 307, 314, 327 (W.D. Pa. 2014) ("[T]he FCR [was appointed] to ensure that future claimants were treated fairly and equitably in the process of developing the Plan and related documents.").

168. See *In re Fairbanks*, 601 B.R. at 838–39 ("The essence of due process is the right to participate in judicial proceedings that affect property interests. Because future claimants, by definition, cannot participate in the process of negotiating the terms of the plan, trust, and channeling injunction, they must have a representative."); Order Approving and Authorizing the Appointment of Lawrence Fitzpatrick as the Future Claimants' Representative, Nunc Pro Tunc to July 11, 2013, at ¶ 3, *In re Rapid-Am. Corp.*, No. 13-10687 (SMB) (Bankr. D. Del. Sept. 03, 2013), ECF No. 129 ("The Future Claimants' Representative shall have the duty to participate in the confirmation process, act as the spokesperson for Future Claimants, represent the Future Claimants for purpose of binding the Future Claimants to all orders as part of such process and perform the functions of a legal representative for those Future Claimants that might assert Demands against the Debtor or its estate[.]").

169. *Pittsburgh Corning*, 518 B.R. at 327.

170. See 11 U.S.C. § 524(g)(4)(B) (providing that validity and enforceability of the injunction against future claimants is subject to subsection (h), which confirms the validity of an injunction entered before section (g) was enacted so long as the legal representative did not object to confirmation of the plan or issuance of the injunction).

injunction,” it does not detail how the FCR carries out that role.<sup>171</sup> We will next examine the current precedent clarifying the role of the FCR as an advocate whose authority to bind future claimants is limited.

### 1. Recent Opinions in Asbestos Cases Have Construed the FCR’s Role as an Advocate

*In re Fairbanks Co.* was the first in a series of rulings where the court focused on the standard applicable to the appointment of an FCR.<sup>172</sup> In the context of a dispute over the process for selecting an FCR, the United States Bankruptcy Court for the District of Georgia discussed the necessary qualifications and qualities of an FCR. The court explained that an FCR “must perform fiduciary-like duties in his or her very special role of negotiating for individuals who will be required to participate in a claim-resolution procedure (the trust via the channeling injunction) that they had no say about.”<sup>173</sup> Consequently, an FCR must be “eminently qualified and knowledgeable[,]” as well as “objective, reasonable, and fair” and capable of being a zealous advocate for future claimants.<sup>174</sup> The court linked these qualities to “[c]onsiderations of due process and the statutory provisions of § 524(g)[,]” finding that a court must “examine a proposed future claimants’ representative’s capabilities beyond qualification and disinterestedness.”<sup>175</sup>

The *Fairbanks* court opined that the FCR must be more than “merely a representative” and “do more than merely provide ‘adequate’ representation.”<sup>176</sup> The FCR “must be an advocate because other parties (primarily the present claimants) have adverse interests in the same property. Due process is meaningless if their representative is unwilling to advocate their interests diligently, competently, and loyally.”<sup>177</sup> The court described future claimants as “substantially similar to minors or incapacitated adults in that they are incapable of representing themselves.”<sup>178</sup> These future claimants have “very real” property rights in the asbestos trust assets that they themselves cannot protect.<sup>179</sup> The court recognized that the FCR “cannot ‘bind’ a specific future claimant in the usual sense of the word,” but because the confirmed plan and channeling injunction will bind those claimants, they require a legal representative.<sup>180</sup> The court determined that the section 524(g) FCR fulfills a role akin to a guardian *ad litem*.<sup>181</sup> Similarly,<sup>182</sup> the Third Circuit requires that an FCR

171. See 11 U.S.C. § 524(g)(4)(B)(i).

172. 601 B.R. 831 (Bankr. N.D. Ga. 2019).

173. *Id.* at 838.

174. *Id.*

175. *Id.* at 838–39.

176. *Id.*

177. *Id.* at 839.

178. *Id.* at 840.

179. *Id.*

180. *Id.*

181. *Id.* at 840–41 (“Just as a guardian ad litem must represent the interests of a ward in litigation determining the ward’s rights and duties, an FCR must advocate on behalf of unknown future claimants in the negotiation of the terms of the plan, trust, and channeling injunction and in the confirmation process to protect future claimants’ rights and give them the best possible opportunity to recover. In summary, a future claimants’ representative effectively undertakes the role of a guardian ad litem.”).

182. *In re Imerys Talc Am., Inc.*, 38 F.4th 361, 374 (3d Cir. 2022).

“act in accordance with a duty of independence from the debtor and other parties in interest in the bankruptcy, a duty of undivided loyalty to the future claimants, and an ability to be an effective advocate for the best interests of the future claimants.”<sup>183</sup>

Other courts that have assessed the role of the FCR often looked to *Manville* and *UNR*. In *In re Duro Dyne National Corp.*,<sup>184</sup> the United States District Court for the District of New Jersey discussed the roles and responsibilities of an FCR, in overruling the U.S. Trustee’s objections to the debtor-nominated FCR.<sup>185</sup> While the objections raised to the proposed FCR focused on whether he was capable of being an independent and effective advocate during the bankruptcy case, the district court focused its analysis on the role provided for the FCR post-confirmation in the asbestos trust agreement.<sup>186</sup> The court went on to describe how the FCR’s duties, albeit with respect to the section 524(g) trust, were similar to the powers and duties provided for in *Manville* and *UNR*.<sup>187</sup>

## 2. The FCR’s Powers, as Established by the Court, Include Limited Authority to Bind Future Claimants

The court plays a significant role in defining the scope of an FCR’s role in any given case. The order appointing an FCR often grants the FCR powers similar to those that a committee holds under section 1103 of the Bankruptcy Code.<sup>188</sup> Indeed, the FCR’s role in some respects is to counterbalance that of the committee of current

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183. *Id.*

184. 2019 WL 4745879, at \*1 (D.N.J. Sept. 30, 2019).

185. *Id.* at \*6.

186. *Id.* at \*9 (“[T]he role of the future claimants’ representative is to consider the best interests of the future claimants, consult with and advise the trustee on the best course of action, and ultimately consent or object to the Trustee’s choices. Should the future claimants’ representative object, it is the Trustee who has the upper hand in resolving the dispute. Although the future claimants’ representative is an essential role in the asbestos trust, his powers do not permit him to bind absent parties.”).

187. *Id.* at \*8 (“The proposed Asbestos Trust Agreement provides that the future claimants’ representative ‘shall serve in a fiduciary capacity, representing the interests of the holders of future Asbestos Claims for the purpose of protecting the rights of such persons.’ But the future claimants’ representative’s power is limited to consulting with the trustee and consenting to certain actions proposed by the trustee; the future claimants’ representative may not unilaterally bind absent persons in the way a guardian ad litem might. For example, it is the trustee who may propose changes to the payment percentage or the claims payment ratio, but no changes may be made without the consent of the future claimants’ representative and current claimants’ committee. Where the trustee must obtain the future claimants’ representative’s consent, the future claimants’ representative does not have the unilateral ability to enact or veto changes. The future claimants’ representative is not required to consent to the trustee’s proposals, but ‘may not withhold his or her consent unreasonably.’ If the future claimants’ representative does not timely inform the trustee of his consent or objections, his ‘consent shall be deemed to have been affirmatively granted.’ If the future claimants’ representative continues to object and withhold consent, the trustee and future claimants’ representative would enter an alternative dispute resolution process, where the burden of proof would be on the future claimants’ representative to show that withholding consent was valid.”) (Internal record citations omitted).

188. See, e.g., *In re Imerys Talc Am., Inc.*, 38 F.4th at 377–78 (finding the role of an FCR to be analogous to a creditors’ committee and stating that the FCR “functions, in effect, as a ‘creditors’ committee’ of one”); *In re Duro Dyne*, 2019 WL 4745879, at \*8 (“In *Johns-Manville*, the legal representative for future claimants had powers similar to a committee under 11 U.S.C. § 1103, which are nonbinding but would allow future claimants a ‘meaningful opportunity to be heard and to participate.’ . . . [T]he legal representative in *UNR* similarly exercised the powers of a committee under § 1103.” (citations omitted)).

claimants.<sup>189</sup> But the FCR's power to bind future claimants is limited. For example, while the FCR represents the future claimants' interest in the bankruptcy case, the future claimants are not bound by the bankruptcy court's jurisdiction, because they have not submitted proofs of claim (and thus have not consented to jurisdiction) or surrendered their rights to a jury trial.<sup>190</sup>

While the FCR typically is provided broad powers to act as required to serve the interests of future claimants, the FCR may need to seek authority from the court to take certain action, such as litigating matters relating to the bankruptcy case. For example, one bankruptcy court found it was appropriate for the FCR, upon obtaining approval from the court, to intervene as a coplaintiff in an avoidance action the asbestos claimants committee had initiated against the debtor's principal stockholder.<sup>191</sup> The court found that nothing in section 524(g), its legislative history, or *Manville* and *UNR* suggested an intent to limit the FCR's role to plan-formation issues—particularly because the facts of each case will dictate the FCR's role, many aspects of the case can be essential to protecting due process, and the court has equitable powers under section 105(a) to shape the FCR's powers.<sup>192</sup> The district court hearing the avoidance action agreed that it was appropriate for the FCR to intervene.<sup>193</sup>

Later cases made clear that an FCR appointed in a section 524(g) case could not be used as an involuntary proxy to bind future claimants in litigation that sidestepped the requirements of the Bankruptcy Code and the Federal Rules of Civil Procedure on class actions.<sup>194</sup> For example, in one bankruptcy case the debtor and related entities tried to use the Declaratory Judgment Act to resolve future asbestos liabilities by making the FCR a defendant.<sup>195</sup> The court observed that the FCR's "function is not clearly established[,] that section 524(g) provides no direction for the FCR's role in bankruptcy proceedings, and that the term "legal representative" is not used in the Bankruptcy Code outside of that section."<sup>196</sup>

While the court had approved the FCR's role in the avoidance action, due process concerns prevented the debtor and related entities from conscripting the FCR to be a defendant in a non-bankruptcy action to determine liability issues.<sup>197</sup> That was because section 524(g) is a specific framework for addressing mass asbestos liabilities, with "statutory prerequisites [that] are 'specifically tailored to protect the due process rights of future claimants.'"<sup>198</sup> Those prerequisites include appointing an FCR as "one of the many procedural safeguards that protect future claimants, who will be bound by terms of the channeling injunction."<sup>199</sup> The FCR's "[m]ere participation" would not bind future

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189. See *In re Federal-Mogul Glob., Inc.*, 684 F.3d 355, 361 n.10 (3d Cir. 2012) ("Although there are usually more representatives of current than future claimants [in the governance of the trust], they possess equal authority and must both consent to substantial modifications of the trust.").

190. *In re W.R. Grace & Co.*, 729 F.3d 332, 346 (3d Cir. 2013).

191. *In re G-I Holdings, Inc.*, 292 B.R. 804, 806–07 (Bankr. D.N.J. May 8, 2003).

192. *Id.* at 814.

193. See *Official Committee of Asbestos Claimants of G-I Holding, Inc. v. Heyman*, 2003 WL 22790916 (S.D.N.Y. Nov. 25, 2003).

194. *In re G-I Holdings, Inc.*, 328 B.R. 691 (D.N.J. 2005).

195. *Id.* at 694.

196. *Id.* at 695.

197. *Id.*

198. *Id.*

199. *Id.* at 696–97.



claimants to the outcome of the declaratory judgment action.<sup>200</sup> The debtor and related entities could not bypass the due process safeguards of both class action Rule 23 and section 524(g), and require the FCR to participate in the action.<sup>201</sup> Moreover, the FCR was not “a guardian ad litem with the power to bind future claimants.”<sup>202</sup>

While FCRs do not have unlimited power to bind future claimants, they do play an important role in safeguarding the due process rights of future claimants who will be bound by an injunction that channels their claims to a trust.

### III. EFFORTS TO ADDRESS FUTURE CLAIMS WITHOUT AN FCR RESULT IN INCREASED UNCERTAINTY

Debtors facing mass tort liability want to achieve a global settlement of claims with certainty that claimants, current or future, will be curtailed from later pursuing them. Before and after the enactment of section 524(g), debtors have sought global settlements by means other than section 524(g) with poor results. Because future claims are by definition not fully developed, attempts to resolve them with finality and without an FCR face certain due process challenges that leave the door open for claimants still to have recourse on account of future claims.

#### A. Resolving Claims Through Class Actions

Prior to and early after enactment of section 524(g), companies struggling with asbestos liability attempted to achieve finality through class-action settlements pursuant to Rule 23 of the Federal Rules of Civil Procedure. Class-action settlements provide an opportunity for defendants to resolve mass liabilities without the risk of a class trial.<sup>203</sup> However, a class-action settlement structure that affords absent future class members due process and resolves future claims with finality has remained elusive.<sup>204</sup>

The Supreme Court decisions *Amchem Products, Inc. v. Windsor*<sup>205</sup> and *Ortiz v. Fibreboard Corp.*<sup>206</sup> exemplify the difficulties in structuring a mass tort settlement class action that complies with Rule 23 and provides due process to future claimants. In *Amchem*, the Court affirmed the Third Circuit’s decertification of a settlement class that included current and future asbestos-related claimants, holding that the class certification did not comply with Rule 23 because

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200. *Id.* at 697.

201. *Id.*

202. *Id.*; see *In re Imerys Talc Am., Inc.*, 38 F.4th 361, 374 n.9 (3d Cir. 2022) (stating that, unlike a guardian *ad litem*, an FCR does not have the ability to bind future claimants). Just as the FCR could not serve as a defendant to bind individual future claimants, the committee also could not bind individual present claimants. *In re G-I Holdings, Inc.*, 2008 WL 11513187, at \*8–9 (D.N.J. May 30, 2008). Considerations of fairness and due process prohibited the use of non-bankruptcy proceedings to bind present and future claimants by naming the committee and FCR as proxy defendants. *Id.* at \*16.

203. See Howard M. Erichson, *The Problem of Settlement Class Actions*, 82 GEO. WASH. U. L. REV. 951, 952 (2014).

204. For a class action to be certified, an individual suing on behalf of all members of a class must satisfy the prerequisites of Rule 23(a) by showing numerosity, commonality, typicality, and adequacy of representation with other class members. See FED. R. CIV. P. 23(a); Joseph W. Gelb et al., *Class Action Settlements in the Aftermath of Amchem Products and Ortiz*, 55 BUS. LAW. 1439, 1439–40 (2000). For a class action that seeks monetary damages, the individual must also show that the action is maintainable under Rule 23(b)(1) or (3). See FED. R. CIV. P. 23(b); *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 615 (1997) (recognizing that Rule 23(b)(2) is limited to actions seeking declaratory or injunctive relief).

205. 521 U.S. 591 (1997).

206. 527 U.S. 815 (1999).

the settlement class failed to satisfy the requirement under Rule 23(b)(3) that common issues predominate over individual issues and the prerequisite under Rule 23(a)(4) of adequacy of representation.<sup>207</sup>

The Court dismissed the district court's reliance on class members' exposure to asbestos products supplied by the defendants as being sufficient to satisfy Rule 23(b)(3)'s predominance requirement.<sup>208</sup> The Court made clear that the predominance requirement of Rule 23(b)(3) is "far more demanding" than the commonality requirement in Rule 23(a) and highlighted the many class cohesion issues within the settlement class.<sup>209</sup> Not only did the Court recognize the disparities between current claimants and future claimants, but it also noted the disparities among the future claimants themselves.<sup>210</sup>

The Court also held that the settlement class failed to provide fair and adequate representation for the future claimants in the class as required by Rule 23(a)(4).<sup>211</sup> Rule 23(a)(4) serves to guard against conflicts of interests and requires that a class representative be a member of the class and share the same interests and injury as the class members.<sup>212</sup> The Court recognized that the interests of those in the single class were not aligned.<sup>213</sup> Notably, some of the class members had current injuries with an interest in receiving "generous immediate payments," while the exposure-only plaintiffs with potential future claims had an interest in "an ample, inflation-protected fund for the future."<sup>214</sup> The Court found that there was "no structural assurance of fair and adequate representation for the diverse groups and individuals affected," as each named party represented the entire constituency and not its respective subgroups.<sup>215</sup>

Two years later, in *Ortiz v. Fibreboard Corp.*,<sup>216</sup> on a "limited fund" rationale the Court reversed a decision from the Fifth Circuit affirming certification of a settlement class, which included current and future asbestos claims, under Rule 23(b)(1)(B).<sup>217</sup> A proposed global settlement was negotiated between certain asbestos plaintiffs' attorneys, Fibreboard, and two of Fibreboard's insurers that provided for a fund to be established from contributions from the two insurers and Fibreboard, with almost all of Fibreboard's contribution coming from other insurance proceeds.<sup>218</sup>

207. See *Amchem Prods.*, 521 U.S. at 628.

208. See *id.* at 623–24. The district court had certified the class under Rule 23(b)(3), which has two prerequisites for certification beyond those required by Rule 23(a): (i) "questions of law or fact common to class members predominate over any questions affecting only individual members," and (ii) "a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." See *id.* at 597; FED. R. CIV. P. 23(b)(3).

209. *Amchem Prods.*, 521 U.S. at 624.

210. See *id.* at 624 ("The [exposure-only] plaintiffs especially share little in common, either with each other or with the presently injured class members. It is unclear whether they will contract asbestos-related disease and, if so, what disease each will suffer. They will also incur different medical expenses because their monitoring and treatment will depend on singular circumstances and individual medical histories.") (quoting *Georgine v. Amchem Prods., Inc.*, 83 F.3d 610, 618 (3d Cir. 1996), *aff'd sub nom.* *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997)).

211. See *Amchem Prods.*, 521 U.S. at 625.

212. See *id.* at 626.

213. See *id.*

214. See *id.*

215. *Id.* at 627.

216. 527 U.S. 815 (1999).

217. See *id.* at 830.

218. See *id.* at 824–25.

To implement the global settlement, certain plaintiffs filed an action seeking certification of a mandatory settlement class under Rule 23(b)(1)(B) based on a limited fund theory.<sup>219</sup> As explained by the Court,

mandatory class treatment through representative actions on a limited fund theory was justified with reference to a “fund” with a definitely ascertained limit, all of which would be distributed to satisfy all those with liquidated claims based on a common theory of liability, by an equitable, pro rata distribution.<sup>220</sup>

The Court held that the settlement class in *Ortiz* was improperly certified because certification under a limited fund theory requires that the scarcity of funds be the result of more than just the parties’ agreement.<sup>221</sup> The Court also took issue with Fibreboard’s listing of its entire net worth in the total amount available for claimants, while retaining all but \$500,000 of such value for itself.<sup>222</sup> The Court noted that allowing such a class-action settlement could undermine the creditor protections provided by the Bankruptcy Code and further noted that section 524(g) of the Bankruptcy Code provided the ability to channel future asbestos claims.<sup>223</sup>

The Court also found that class certification was not appropriate because the proposed distribution of the fund among the class was not fair.<sup>224</sup> The Court held that the class did not comply with *Amchem*, because the class included holders of present and future claims, whose conflicting interests required division of the class into homogeneous subclasses with separate representation.<sup>225</sup> The Court found that this failure to classify future claimants separately violated the equitable obligations under Rule 23(b)(1)(B) and the prerequisite of adequacy of representation under Rule 23(a)(4).<sup>226</sup> The Court also found that those class members exposed to asbestos prior to the expiration of applicable insurance had more valuable claims and should not have been in the same class as those exposed after such insurance expired.<sup>227</sup>

The uncertainty involved with resolving future mass tort claims in a class-action settlement make it an increasingly untenable option. The viability of resolving mass tort claims through class certification under Rule 23(b)(1) has effectively been eliminated, and it is unclear whether putting future claimants together in a subclass (or multiple subclasses) can ever satisfy Rule 23(b)(3)’s predominance standard. Even if a class-action settlement could be structured to satisfy Rule 23(b)(3), great uncertainty remains about if (and how) the interests of future claimants can be adequately represented and protected in accordance with Rule 23(a) and due process requirements.

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219. See *id.* at 825–27.

220. *Id.* at 841.

221. See *id.* at 821.

222. See *id.* at 859–60.

223. See *id.* at 860 n.34.

224. See *id.* at 855.

225. See *id.* at 856–57.

226. See *id.* While the district court had appointed a guardian *ad litem* to assess the settlement on behalf of future claimants, the court did not address the propriety of such appointment in its opinion. See *id.* at 827.

227. See *id.* at 857.

## B. Discharging Claims with a Claims Reinstatement Option

Although there is some precedent for leaving future claimants the option of reinstating their discharged claims against a debtor's estate under Federal Rule of Bankruptcy Procedure 3003(c), such a "solution" provides insufficient recourse.

In *In re Energy Future Holdings Corp.*,<sup>228</sup> the Third Circuit addressed the propriety of claims reinstatement in determining "whether and under what circumstances a bankruptcy debtor's Chapter 11 plan of reorganization may discharge the claims of latent asbestos claimants."<sup>229</sup> While facing asbestos liabilities that cost several million dollars per year, the debtors did not pursue a reorganization under section 524(g).<sup>230</sup> Instead, they pursued a sale structure that was conditioned upon plan confirmation, pursuant to which the buyer proposed to pay all asbestos claims filed by the bar date and leave discharged claims to follow a post-confirmation reinstatement process under Rule 3003(c) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").<sup>231</sup>

The Third Circuit affirmed the bankruptcy court's determination that the debtor's plan could discharge latent claims "so long as the claimants receive an opportunity to reinstate their claims after the debtor's reorganization that comports with due process."<sup>232</sup> The Third Circuit found that the process for latent claimants to have their claims reinstated under Bankruptcy Rule 3003(c), while not facially inadequate, nonetheless afforded claimants the opportunity to argue that, under the *Grossman's* factors, permanent discharge would not comply with due process.<sup>233</sup> Despite upholding the process, the Third Circuit expressed its regret that the debtor even asked for a bar date.<sup>234</sup> The court stated that the case "serves as a cautionary tale" to those not following the section 524(g) model because while the process produced a similar result to that afforded by a trust—satisfying claims for those who filed claims or did not receive proper notice—it did so with "added and unnecessary back-end litigation."<sup>235</sup>

## C. Barring Claims Through "Free and Clear" Sales Under Section 363 of the Bankruptcy Code

As discussed above, future claims cannot be discharged under a plan of reorganization unless future claimants are afforded due process. Likewise, assets cannot be sold "free and clear," and a purchaser will not be shielded from successor liability for future claims, unless due process is afforded to future claimants.<sup>236</sup> However, it is far from clear whether adequate due process for latent claimants can ever be satisfied in the context of a section 363 sale.

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228. 949 F.3d 806 (3d Cir. 2020).

229. *Id.* at 811.

230. *Id.* at 813.

231. *Id.* at 814.

232. *Id.* at 811.

233. *Id.* at 822–25.

234. *Id.* at 825.

235. *Id.*

236. See, e.g., *Schall v. Suzuki Motor of Am., Inc.*, 2020 WL 1542388, at \*6 (W.D. Ky. March 31, 2020) (finding that "a non-debtor plaintiff's successor liability claim against the debtor's asset purchaser is not extinguished by a § 363 sale where the plaintiff did not receive constitutionally adequate notice").

In a section 363 sale, the same issues discussed in Section II above concerning providing notice to known and unknown claimants arise.<sup>237</sup> However, in contrast to chapter 11 reorganization cases, sale cases under section 363, because they are outside of a plan, do not have the stand-alone ability to follow the long-standing section 524(g) model that is premised on a channeling injunction and a trust established through a chapter 11 plan. Therefore, whether due process can be afforded to future claimants in such sale cases even if an FCR is appointed remains uncertain.<sup>238</sup>

#### IV. EXPANDING THE FCR FRAMEWORK BEYOND ASBESTOS AFFORDS FAIRNESS AND FINALITY IN OTHER MASS TORT CONTEXTS

As discussed *supra*, when a company foresees an ongoing stream of litigation that places its future in jeopardy, bankruptcy provides an opportunity to preserve the company in the long term. However, the reorganizing process is meaningful to companies facing mass tort liabilities only if they can address long-term future claims that will arise after plan confirmation. Thus, due process concerns for future claimants must be addressed. To that end, in several non-asbestos mass tort cases, the courts have approved of plans to follow a structure similar to that of the section 524(g) model, including appointment of an FCR.<sup>239</sup>

Offering twenty-five years of precedent, the section 524(g) model and the appointment of an FCR form the most proven way to address due process concerns for future claimants while providing certainty for reorganized debtors. The expansion of the use of FCRs into other types of mass tort cases, such as those involving environmental, sexual abuse, or opioid claims, reinforces the benefits of this model and suggests that FCRs should be used in additional contexts to account for the significant interests of both future claimants and reorganizing debtors.

##### A. Personal Injury Claims Based on Environmental Liability

While the future claims of individuals exposed to asbestos are the only mass tort claims that can explicitly be managed under section 524(g), mass tort liabilities resulting from exposure to other substances should follow that model. For companies that utilized potentially toxic chemical substances, the risk that they may cause personal injury is high.<sup>240</sup> Given the uncertainty caused by the often long latency periods between exposure to chemical substances and the

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237. See *In re Motors Liquidation*, 829 F.3d 135, 161 (2d Cir. 2016) (finding that successor liability claims were not barred because sale notice was deficient due to inadequate notice to vehicle owners based on debtor's failure to provide actual notice not just publication notice when the debtor knew or reasonably should have known about the vehicle defect prior to the bankruptcy); *Schall*, 2020 WL 1542388, at \*7 (finding that claim was not barred by sale order because claimant had not received adequate notice because no one could have known at the time of the bankruptcy case claimant would ever have a claim); *Morgan Olsen L.L.C. v. Frederico (In re Grumman Olson Indus. Inc.)*, 467 B.R. 694, 696–97 (S.D.N.Y. 2012) (same).

238. See *In re Grumman*, 467 B.R. at 711 (“The Court does not decide whether or not there may be circumstances under which a Section 363 sale order could extinguish the claims of future claimants who, because they were not injured before the close of the bankruptcy, had no way to receive notice of the bankruptcy proceedings. And the Court does not reach any conclusion regarding whether use of a future claims representative can always address the due process concerns of unknown future claimants, nor whether use of such a representative would have been possible or appropriate in the bankruptcy proceedings here.”).

239. In non-asbestos cases, bankruptcy courts appoint FCRs using their equitable powers. See 11 U.S.C. § 105(a) (“The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”); *In re Motors Liquidation Co.*, No. 09-50026 (Bankr. S.D.N.Y. April 8, 2010), ECF No. 5459 (order granting debtors’ motion to appoint an FCR pursuant to sections 105 and 1109 to resolve future asbestos claims outside of the section 524(g) framework); *In re Met-Coil Sys. Corp.*, No. 03-12676 (Bankr. D. Del. Oct. 20, 2003), ECF No. 206 (order appointing FCR for holders of future personal injury claims based on exposure to trichloroethylene); *In re CBC Framing, Inc.*, No. 09-20610 (Bankr. C.D. Cal. Feb. 19, 2010), ECF No. 228 (order appointing FCR for holders of claims not discovered before effective date of framing-contractor debtor’s plan).

240. Eric D. Green et al., *Future Claimant Trusts and “Channeling Injunctions” to Resolve Mass Tort Environmental Liability in Bankruptcy: The Met-Coil Model*, 22 EMORY BANKR. DEVS. J. 157, 159 (2007).

manifestation of injury, ongoing and future toxic tort litigation has the potential to create insurmountable financial difficulties for a company.

For example, Met-Coil Systems Corporation spent \$18 million before filing bankruptcy defending and paying personal injury lawsuits by residents of a neighborhood it allegedly contaminated with trichloroethylene.<sup>241</sup> Following the model of section 524(g), the Met-Coil bankruptcy case involved the appointment of an FCR, the establishment of a post-confirmation settlement trust to which the future liabilities were funneled under the confirmed plan, and the entry of a channeling injunction pursuant to section 105(a) of the Bankruptcy Code<sup>242</sup> Met-Coil's success with the section 524(g) model demonstrates that the use of an FCR could be beneficial in other cases involving the release of toxic chemicals into the environment.<sup>243</sup>

## B. Sexual Abuse Claims

As latency issues featured prominently in asbestos litigation, victims of sexual abuse may also suffer from a delay between when an injury occurred and when the injury manifests because of age or a psychological or cognitive response that represses the injury. The American Counseling Association reports that children make up the majority of sexual abuse victims in the United States.<sup>244</sup> Approximately 28–33% of women and 12–18% of men were victims of childhood sexual abuse.<sup>245</sup> The scope of childhood sexual abuse is difficult to estimate as 73% of children do not report for at least a year, 45% of children do not report for at least five years, and some never report at all.<sup>246</sup> Being a victim of childhood sexual abuse is associated with greater levels of depression, self-blame, guilt, shame, eating disorders, harmful associative patterns, denial, repression, sexual problems, and relationship issues.<sup>247</sup> Some of these injuries may not manifest immediately, and some survivors may repress or dissociate from the abuse, making it difficult to address at the time of the injury.<sup>248</sup> The nature of sexual abuse and the latency period between the injury and its manifestation present issues similar to those posed by liability arising from exposure to asbestos.

An FCR has been appointed in several bankruptcy cases involving the claims of persons who were sexually abused, typically while the claimants were children.<sup>249</sup> For example, in the case involving the Roman Catholic Archdiocese of Portland, Oregon, the Bankruptcy Court for the District of Oregon discussed the role of the FCR in the context of bankruptcies concerning sexual abuse allegedly perpetrated by priests.<sup>250</sup> The FCR, called the Unknown

241. *Id.* at 157.

242. *Id.* at 158.

243. *Id.* at 181–83.

244. Melissa Hall & Joshua Hall, *The Long-Term Effects of Childhood Sexual Abuse: Counseling Implications* at 2, AM. COUNSELING ASS'N: VISTAS ONLINE (2011), [https://www.counseling.org/docs/disaster-and-trauma\\_sexual-abuse/long-term-effects-of-childhood-sexual-abuse.pdf](https://www.counseling.org/docs/disaster-and-trauma_sexual-abuse/long-term-effects-of-childhood-sexual-abuse.pdf).

245. *Id.* at 1.

246. *Child Sexual Abuse Facts & Resources*, CHILD'S ASSESSMENT CTR., <https://www.cachouston.org/sexual-abuse/child-sexual-abuse-facts/> (last visited July 16, 2020).

247. Hall, *supra* note 244, at 2.

248. *Id.* at 2–4.

249. See *In re Roman Cath. Archbishop of Portland*, 2005 WL 148775, at \*1 (Bankr. D. Or. Jan. 10, 2005); Order Appointing James L. Patton, Jr., as Legal Representative for Future Claimants, Nunc Pro Tunc to the Petition Date, *In re Boy Scouts of Am.*, C.A. No. 20-10343 (LSS) (Bankr. D. Del. Apr. 24, 2020), ECF No. 486 [hereinafter BSA Appmt. Order].

250. *In re Roman Cath. Archbishop of Portland*, 2005 WL 148775, at \*1.

Claims Representative in that case, was appointed to protect the interests of “certain unknown individuals holding claims against debtor who will fail to formally assert those claims by the bar date.”<sup>251</sup>

The parties agreed that the FCR’s role was to “represent the interest of individuals who are currently minors and whose parent or legal guardian does not file a timely claim (hereinafter ‘minors’) and those with repressed memory who have no knowledge of the wrongful conduct resulting in their claim against debtor,” but they disagreed as to whether the scope of his representation should be broader.<sup>252</sup> The court cited approvingly an earlier chapter 11 case involving the Catholic Diocese of Tucson, in which the Unknown Claims Representative was given wide-ranging duties, including the authority to file a proof of claim on behalf of the class he represents. This class was composed of “those persons who are of adult age whose claims currently exist but who do not realize and will not realize, prior to the April 15, 2005, deadline for filing claims, that they have claims against the estate.”<sup>253</sup>

Likewise, the court cited *Manville* approvingly, noting that the approach taken in the Portland and Tucson diocese cases was “consistent with that taken in the ‘mass tort’ asbestos bankruptcy cases.”<sup>254</sup> The court highlighted the “important factual similarity” of a “possibility of a long latency period before which injury becomes manifest” in both the sexual abuse cases and the asbestos cases.<sup>255</sup> As with asbestosis and related diseases, the court noted that “when childhood sexual abuse causes an injury, the injury may not be manifest for many years.”<sup>256</sup>

Similarly, in *In re Boy Scouts of America*, another case involving the alleged sexual abuse of minors, the bankruptcy court appointed an FCR under sections 105(a) and 1109(a) of the Bankruptcy Code<sup>257</sup> to represent the interests of future claimants.<sup>258</sup>

While the protections of section 524(g) are not explicitly provided to victims of sexual abuse, the courts have recognized the key role that an FCR can serve in protecting the due process rights of future claimants in these cases. By utilizing an FCR and following the section 524(g) model of a settlement trust and channeling injunction, these debtors are also less likely to face additional litigation after reorganizing. Companies seeking bankruptcy protection in the future to address liabilities arising from sexual abuse should consider the value of having an FCR appointed.

### C. Defective Consumer Products

When a widely distributed consumer product is defective, estimating the number and magnitude of claims is subject to great uncertainty, and providing notice to potential claimants is difficult. Depending on the nature of the

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251. *Id.*

252. *Id.*

253. *Id.* at \*3 (internal citations omitted).

254. *Id.*

255. *Id.*

256. *Id.*

257. Debtors’ Motion for Entry of an Order Appointing James L. Patton, Jr., as Legal Representative for Future Claimants Nunc Pro Tunc to the Petition Date, *In re Boy Scouts of Am.*, No. 20-10343 (LSS) (Bankr. D. Del. Feb. 18, 2020), ECF No. 223.

258. BSA Appmt. Order, *supra* note 249, at ¶ 4 (defining, without prejudicing the right of the debtors, the FCR, or the court to seek to modify the definition in conjunction with plan confirmation, future claimants as “individuals holding a claim based on abuse that occurred prior to the Petition Date, but who have not filed a proof of claim by the applicable bar date and who, as of the date immediately preceding the Petition Date: had not attained eighteen (18) years of age, or were not aware of such Abuse Claim as a result of ‘repressed memory,’ to the extent the concept of repressed memory is recognized by the highest appellate court of the State or territory where the claim arose”).

product, there may not be records of ownership, and, even in instances where original ownership may be known, identifying potential claimants can be complicated by the transient nature of consumer products. In such cases, adopting the FCR model can be an effective strategy to achieve a fair and final resolution for future claims.

The Takata bankruptcy provides a good example.<sup>259</sup> Approximately 67 million vehicles with Takata airbags have been recalled because long-term exposure to humidity and heat can cause the air bags to explode when deployed, causing injury and death.<sup>260</sup> As a result, in June 2017, Takata Americas, TK Holdings, Inc., and certain affiliates sought bankruptcy protection due to the enormous cost associated with the airbag safety crisis.<sup>261</sup> During the *Takata* bankruptcy proceedings, the court appointed an FCR with respect to future claims related to certain defective airbag inflator components.<sup>262</sup>

Takata proposed, and the court ultimately confirmed, a chapter 11 plan to effectuate a sale of substantially all of its assets, other than those related to the defective inflator components, and, modeled on section 524(g), to channel to a trust all claims related to the defective components.<sup>263</sup> In support of confirmation of the chapter 11 plan, the FCR submitted a declaration similar in structure to FCR declarations filed in support of section 524(g) plans.<sup>264</sup> The FCR declared that he found the plan to be fair and equitable in its treatment of future claims that would be channeled to the trust, and that the trust's distribution procedures provided reasonable assurance that the trust would value and be able to pay claims, "in a fair, objective, reasonable, and efficient manner."<sup>265</sup>

Takata filed for bankruptcy because of the massive liabilities associated with defective airbags in the present and in the future, and a prospective buyer was not willing to take the risk of future claims. A plan of reorganization with a sale of substantially all the assets would be attractive to a buyer only if it accounted for future claimants that may have Takata airbags in their cars but have not yet suffered injury. An FCR was beneficial in this case, as in other mass tort cases, because the FCR could advocate on behalf of future claimants and ensure that their right to due process was protected while also providing some sense of certainty for the business moving forward. This model would be similarly effective in other mass tort cases.

## D. Opioid Claims

From 1999 to 2020, more than 564,000 people in the United States died from drug overdoses involving an opioid.<sup>266</sup> The first wave of the opioid epidemic is considered to have begun in the 1990s with the increased use of

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259. *In re TK Holdings Inc.*, No. 17-11375 (BLS) (Bankr. D. Del. June 25, 2017).

260. *Takata Recall Spotlight*, NHTSA, <https://www.nhtsa.gov/equipment/takata-recall-spotlight> (last visited Oct. 14, 2022).

261. Jethro Mullen, *Takata, Brought Down by Airbag Crisis, Files for Bankruptcy*, CNN BUS. (June 26, 2017), <https://money.cnn.com/2017/06/25/news/companies/takata-bankruptcy/index.html>.

262. See *In re TK Holdings Inc.*, No. 17-11375 (BLS), 2018 WL 1306271, at \*6 (Bankr. D. Del. Mar. 13, 2018); Order Appointing Roger Frankel as Legal Representative for Future Personal Injury Claimants Nunc Pro Tunc to July 20, 2017, *In re TK Holdings Inc.*, No. 17-11375 (BLS), 2018 WL 1306271 (Bankr. D. Del. Mar. 13, 2018), ECF No. 703.

263. See *In re TK Holdings Inc.*, No. 17-11375 (BLS), 2018 WL 1306271 (Bankr. D. Del. Mar. 13, 2018).

264. See Declaration of Roger Frankel, the Future Claimants' Representative, in Support of Confirmation of the Fourth Amended Joint Plan of Reorganization of TK Holdings Inc. and Its Affiliated Debtors, *In re TK Holdings Inc.*, No. 17-11375 (BLS) (Bankr. D. Del. Feb. 14, 2018), ECF No. 2067.

265. *Id.*

266. *Opioid Data Analysis and Resources*, CENTERS FOR DISEASE CONTROL AND PREVENTION, <https://www.cdc.gov/opioids/data/analysis-resources.html> (last reviewed Aug. 8, 2023).



prescribed opioids for pain management.<sup>267</sup> Gradually, the nature of the opioid epidemic has changed over the years to a reliance on heroin and other synthetic opioids.<sup>268</sup> As of 2019, more than 30 states and almost 1,500 counties and cities have filed civil suits against pharmaceutical companies, manufacturers, pharmacies, and wholesalers for their role in the opioid crisis.<sup>269</sup> Experts believe these lawsuits are likely to lead to marketing restrictions for the drugs and the largest settlement since “Big Tobacco” paid out \$250 billion in 1998.<sup>270</sup>

Facing the growing liabilities for opioid misuse, opioid manufacturers have sought to reorganize under the Bankruptcy Code. While two prior bankruptcies filed by opioid manufacturers did not entail the appointment of an FCR or a broad scheme for addressing future claimants (other than for certain claims of minor children), a third bankruptcy case did.<sup>271</sup>

In that case, the debtors sought and obtained the appointment of an FCR.<sup>272</sup> The debtors initially moved for the appointment of an FCR shortly after the petition date but faced objections from creditors’ groups representing opioid personal injury victims on the basis that the appointment of an FCR was unnecessary or inappropriate for the opioid claims. Those groups suggested that future claims (as well as present claims) should be addressed as part of the process of establishing a claims bar date.<sup>273</sup>

The debtors argued that appointment of an FCR is appropriate if *any* future claimants exist, to ensure an effective discharge of all opioid claims.<sup>274</sup> Further, the debtors distinguished their case from the opioid cases that had not retained FCRs.<sup>275</sup> Based upon the months-long supply chain for the debtors’ products reaching the market and years-

267. *Id.*

268. *Id.*

269. Erin Quinn-Kong, *An Introduction to Opioid Litigation*, JURIST (Feb. 4, 2019), <https://www.jurist.org/commentary/2019/02/an-introduction-to-the-opioid-litigation/>.

270. *Id.*

271. See *In re Insys Therapeutics, Inc.*, No. 19-11292 (KG) (Bankr. D. Del. June 10, 2019); *In re Purdue Pharma L.P.*, No. 19-23649 (RDD) (Bankr. S.D.N.Y. Sept. 15–16, 2019).

272. Order Appointing Roger Frankel, as Legal Representative for Future Opioid Personal Injury Claimants, Effective as of the Petition Date, *In re Mallinckrodt PLC*, No. 20-12522 (JTD) (Bankr. D. Del. June 11, 2021), ECF No. 2813 [hereinafter MNK Final Appt. Order].

273. Motion of Debtors for Entry of an Order Appointing Roger Frankel, as Legal Representative for Future Claimants, Effective as of the Petition Date, *In re Mallinckrodt* (Bankr. D. Del. Oct. 13, 2020), ECF No. 189; Objection of Ad Hoc Group of Personal Injury Victims to Motion of Debtors for Entry of an Order Appointing Roger Frankel, as Legal Representative for Future Claimants, Effective as of the Petition Date, *In re Mallinckrodt* (Bankr. D. Del. Nov. 28, 2020), ECF No. 657; The Official Committee of Opioid Related Claimants’ (I) Request for Adjournment of or, in the Alternative, Objection to Motion of Debtors to Appoint Future Claimants Representative and (II) Cross-Motion to Compel Debtors to Establish Bar Date and Noticing Program for Opioid Claimants *In re Mallinckrodt* (Bankr. D. Del. Nov. 28, 2020), ECF No. 658; The Ad Hoc Committee of NAS Children’s Objection and Joinder to the Official Committee of Opioid Related Claimants’ (I) Request for Adjournment of or, in the Alternative, Objection to Motion of Debtors to Appoint Future Claimants Representative and (II) Cross-Motion to Compel Debtors to Establish Bar Date and Noticing Program for Opioid Claimants, *In re Mallinckrodt* (Bankr. D. Del. Nov. 28, 2020), ECF No. 659.

274. Debtors’ Omnibus Reply in Support of Motion of Debtors for Entry of an Order Appointing Roger Frankel, as Legal Representative for Future Claimants, Effective as of the Petition Date, *In re Mallinckrodt* (Bankr. D. Del. Dec. 7, 2020), ECF No. 744.

275. *Id.*

long shelf-life, the debtors asserted that “it is entirely unknown when thereafter the product may be ingested, or may be alleged to cause harm.”<sup>276</sup>

In further support of the appointment of an FCR, the non-tort creditors’ committee agreed that having “[a]n FCR provides the greatest degree of certainty that opioid claims in these bankruptcy cases will be resolved through the chapter 11 process.”<sup>277</sup> While the committee qualified its support for the appointment of an FCR by maintaining that a bar date process could also be effective, it nevertheless stated that leaving the door open for future claims to challenge the plan based on ineffective due process would harm the unsecured creditors by depressing the reorganized debtors’ enterprise value and increasing costs.<sup>278</sup>

The court granted the debtors’ motion and appointed an FCR. In the final appointment order, the court delineated the FCR’s role as being “to protect the rights of a Future Opioid PI Claimant which is a holder of either a Future Opioid PI Claim or a PI Opioid Demand as such terms (and any related terms) shall be defined in the confirmed plan of reorganization, with the reasonable consent of the Debtors, the Future Claims Representative,” and certain other parties involved in plan negotiations.<sup>279</sup> The order also provided the FCR with standing as a party in interest, powers and duties similar to those of a committee to the extent appropriate for an FCR, the right to receive notice, the authority to engage professionals, and the ability to seek compensation.<sup>280</sup>

Notably, the order expressly stated that it was not addressing any allocations or procedures for a trust to be established under a proposed plan of reorganization.<sup>281</sup> Likewise, the order made no determination, and did not constitute an admission by any party, that any Future Opioid PI Claimants or Future Opioid PI Claims even existed in the case.<sup>282</sup>

While issues related to future claimants in the context of opioid cases are evolving, *Mallinckrodt* demonstrates that the unique facts and circumstances of a case might warrant the appointment of an FCR and, further, that courts and participating parties have great flexibility in delineating the parameters of the FCR role and its impact on the case.<sup>283</sup>

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276. Declaration of Stephen A. Welch in Support of Motion of Debtors for Entry of an Order Appointing Roger Frankel, as Legal Representative for Future Claimants, Effective as of the Petition Date at 3–4, *In re Mallinckrodt* (Bankr. D. Del. Dec. 7, 2020), ECF No. 745.

277. MNK Final Appt. Order, *supra* note 272.

278. *Id.*

279. MNK Final Appt. Order, *supra* note 272, at ¶ 4. The court previously appointed the FCR on a provisional basis. See Order Provisionally Appointing Roger Frankel as Legal Representative for Future Claimants, *In re Mallinckrodt* (Bankr. D. Del. Mar. 1, 2021), ECF No. 1747.

280. MNK Final Appt. Order, *supra* note 272, at ¶ 5(a).

281. *Id.* ¶ 7.

282. *Id.* ¶ 8. The definition of Future Opioid PI Claims was resolved as part of plan confirmation. See Findings of Fact, Conclusions of Law, and Order Confirming Fourth Am. Joint Plan of Reorganization (with Technical Modifications) of Mallinckrodt PLC and Its Debtor Affiliates Under Chapter 11 of the Bankruptcy Code, *In re Mallinckrodt* (Bankr. D. Del. Mar. 2, 2022), ECF No. 6660.

283. The record for using a model similar to that of section 524(g) is also evolving as to the appropriate scope of non-debtor third parties eligible for protection by a channeling injunction or other non-consensual release of liability.

This issue recently came to a head in *Purdue Pharma*, where the bankruptcy court confirmed the debtors’ reorganization plan that included non-consensual releases of certain non-debtors, including Sackler family members named as defendants in thousands of opioid litigation suits, in exchange for a \$4.3 billion plan contribution. See Findings of Fact, Conclusions of Law, and Order Confirming the Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors, at ¶ II, *In re Purdue Pharma L.P.*, No. 19-23649 (Bankr. S.D.N.Y. Sept. 17, 2023), ECF No. 3787. In vacating the confirmation order on appeal to the district court, Judge Colleen J. McMahon concluded that while the bankruptcy court had subject-matter

## V. CONCLUSION

While there is no perfect solution for the issues posed by mass torts and future claims arising from latent injuries, the section 524(g) framework, with the appointment of an FCR, is a superior option, which provides the best possible balance between the competing bankruptcy policies of ensuring a fresh start for the debtor and fair treatment for creditors. Future claimants raise significant due process concerns for debtors attempting to discharge their claims through plan confirmation or a section 363 sale.

The *Manville* and *UNR* model was adopted by Congress as the mechanism for dealing with asbestos liabilities in bankruptcy in section 524(g). Because numerous companies have used section 524(g) to reorganize, there are more than twenty-five years of precedent to provide insight into the role and duties of an effective FCR. The FCR must be an advocate for future claimants to protect their due process rights, but a debtor seeking to discharge future claims during the bankruptcy process also benefits from the participation of an effective FCR. Appointing an FCR and following the section 524(g) model, even for debtors not facing asbestos liability, forms the only confirmed path to address due process for future claimants. This model should be considered in more mass tort contexts moving forward as it provides long-term recovery options for future claimants and greater certainty for debtors seeking finality in a reorganization.

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jurisdiction to address the release of claims against non-debtor third parties, it lacked statutory authority to approve a plan that non-consensually provided for such a release. See *In re Purdue Pharma L.P.*, 2021 WL 5979108, at \*38 (S.D.N.Y. Dec. 16, 2021). However, the Second Circuit reversed Judge McMahon's decision on further appeal, holding that the Bankruptcy Code does permit such releases under sections 105(a) and 1123(b)(6) upon certain factual findings and satisfying certain equitable concerns. See *In re Purdue Pharma L.P.*, 69 F. 4th 45, 68–69, 75–78 (2d Cir. 2023). That decision is now stayed pending oral argument after the Supreme Court granted certiorari to consider the following question: “Whether the Bankruptcy Code authorizes a court to approve, as part of a plan of reorganization under Chapter 11 of the Bankruptcy Code, a release that extinguishes claims held by nondebtors against nondebtor third parties, without the claimants’ consent.” See *Harrington v. Purdue Pharma L.P.*, 2023 WL 5116031 (mem) (U.S. Aug. 10, 2023).

We further note that in a bankruptcy case not involving mass-tort liabilities, a Virginia district court cited Judge McMahon's decision in *Purdue Pharma* when it vacated the plan-confirmation order of Mahwah Bergen Retail Group, Inc. (f/k/a Ascena Retail Group, Inc.) and its debtor affiliates because the order contained “shocking[ly]” broad non-debtor releases. *Patterson v. Mahwah Bergen Retail Grp.*, 636 B.R. 641, 655 (E.D. Va. 2022) (E.D. Va. 2022). To ensure that such releases are appropriate and constitutional, the court suggested that a bankruptcy court should issue a report and recommendation to the district court—a process not unlike what section 524(g) prescribes for an effective injunction. *Id.* at 676; 11 U.S.C. § 524(g)(3)(A) (providing that a channeling injunction is valid and enforceable if the order confirming a plan “was issued or affirmed by the district court”).

*Purdue Pharma*, or perhaps some progeny of *Ascena*, likely will carve the next landmark in the landscape regarding the scope of third-party claims that can be released in non-524(g) cases.