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Third Circuit Rules Successor Liability Claims Are "Generalized Claims," and Therefore, Property of Bankruptcy Estate – Not Individual Creditors

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Bankruptcy creditors who are contemplating the filing of a claim against non-debtor third parties will want to consider the Third Circuit's decision in ***In re Emoral, Inc.***, — F.3d —, (3d Cir 2014). The Third Circuit recently determined that personal injury causes of action asserted against a third-party non-debtor corporation on a "mere-continuation" theory of successor liability are properly characterized as "generalized claims" constituting property of a bankruptcy estate and, therefore, can only be asserted by the bankruptcy trustee.

Emoral manufactured and sold various chemicals including Diacetyl, an organic chemical compound used in the food flavoring industry to add a "buttery flavor" to various products such as popcorn or margarine. Multiple factory works filed personal injury claims against Emoral and others claiming they were harmed by overexposure to Diacetyl. Eventually, Emoral would sell the majority of its assets to Aaroma Holdings ("*Aaroma*") and Emoral ceased operating. Aaroma did not assume any of Emoral's liability to the Diacetyl Plaintiffs nor did Aaroma purchase Emoral's corresponding insurance coverage. Eventually, Emoral filed for Chapter 7 bankruptcy and a Chapter 7 Trustee (the "*Trustee*") was appointed. After investigating the sale of assets, the Trustee claimed that Aaroma did not pay adequate consideration for the assets and, therefore, the assets were fraudulently transferred to Aaroma. The Trustee and Aaroma entered into a settlement agreement (the "Agreement") whereby Aaroma paid the Trustee $500,000.00 and, in return, the Trustee released Aaroma from "any cause of action … that are property of the Debtor's Estate as of the date of the Agreement."

The Diacetyl Plaintiffs objected to the Settlement to the extent the Settlement released Aaroma from any successor liability claims that could be asserted by the Diacetyl Plaintiffs. Counsel for the Debtor stated that the successor liability claims for personal injuries related to Diacetyl against Aaroma "do not belong to the Estate" and therefore the Trustee "can't release them." Ultimately the parties added the following language to the Order approving the Settlement: "Nothing contained in this Order or in the [Settlement] will operate a release of, or a bar to prosecution of any claims held by any person which do not constitute Estate's Released Claims as defined in the [Settlement]."

Soon thereafter, the Diacetyl Plaintiffs filed complaints against Aaroma alleging personal injury and product liability claims asserting Aaroma was a "mere continuation" of Emoral and, therefore, liable as a successor to Emoral. To establish liability under a "mere continuation" theory in New Jersey, a plaintiff must establish that there is continuity in management, shareholders, personnel, physical location, assets and general business operations between the selling and purchasing corporations following the asset acquisition." Ramirez v. Amsted Indus. Inc., 86 N.J. 332, 342 (1981). The successor liability claims are fact specific and seek to promote equity and avoid unfairness. Baker v. Nat'l State Bank, 161 N.J. 220, 227-28 (1999).

Aaroma filed a motion in bankruptcy court seeking to enforce the Settlement by barring the Diacetyl Plaintiffs from filing suit against Aaroma. The Diacetyl Plaintiffs opposed the motion arguing that their claims were not an asset of the estate and, therefore, not released. The Bankruptcy Court denied Aaroma's motion holding that the personal injury causes of action were not property of the estate because the Diacetyl Plaintiffs alleged "a particular injury not generalized injury suffered by all shareholders or creditors of Emoral." Aaroma appealed to the District Court and the District Court reversed finding that the Diacetyl Plaintiffs had no cause of action against Aaroma except on a successor liability theory. The District Court held that the cause of action for successor liability was a "generalized" claim belonging to the estate because the facts giving rise to the cause of action were not specific to the Diacetyl Plaintiffs but common to all creditors. If the Diacetyl Plaintiffs were successful, it would benefit all creditors of Emoral. The Diacetyl Plaintiffs appealed to the Third Circuit.

In a 2-1 decision, the Third Circuit upheld the District Court finding successor liability claims that arose pre-petition are generalized claims and, therefore, an asset of the bankruptcy estate. The Third Circuit relied upon the New York Bankruptcy Court decision, In re Keene Corp., 164 B.R. 844, 849 (Bankr.S.D.N.Y. 1994), where creditors alleged they had claims for asbestos-related injuries against Keene, the debtor corporation, and brought various lawsuits against certain third-party non-debtor defendants, alleging that Keene wrongfully transferred assets to those defendants preventing the creditors from collecting damages. The Keene Court found that since the success of a successor liability claim would increase the assets available for distribution to all creditors, the claim was a generalized claim belonging to the bankruptcy estate and not a separate class of creditors. The Third Circuit also relied upon the New Jersey Bankruptcy Court's decision, In re Buildings by Jamie, Inc., 230 B.R. 36, 43 (Bankr.D.N.J. 1998), where the court concluded that individual creditors lacked standing to bring an alter-ego veil-piercing cause of action seeking recovery from non-debtor third-party defendants, because the cause of action constituted property of the bankruptcy estate. The Jamie Court ruled that the cause of action was "properly characterized as a general claim as to which the trustee alone has standing as representative of the estate." The Third Circuit ruled that "just as the purpose behind piercing the corporate veil, however, the purpose of successor liability is to promote equity and avoid unfairness, and it is not incompatible with that purpose for a trustee, on behalf of a debtor corporation, to pursue that claim."

Judge Cowen authored a dissenting opinion focusing, not on the generalized theory of successor liability, but the individualized claims asserted by the Diacetyl Plaintiffs. "The successor liability theory alleged by the Diacetyl Plaintiffs is inextricably tied to- and cannot be considered separate or apart from- their underlying personal injury and product liability allegations." Therefore, only the Diacetyl Plaintiffs could bring their particular claims against Aaroma, no one else. In support of his position, Judge Cowen cites to the Third Circuit's decision, Bd. Of Trustees of Teamsters Local 863 Pension Fund v. Foodtown, Inc., 296 F.3d 164, 169 (3d Cir. 2002). In Foodtown, the Third Circuit found that a pension fund's claim against third party affiliates of a debtor employer did not constitute property of the debtor's bankruptcy estate because the alleged injury stemmed from liability owed specifically to the pension fund and not the debtor. Judge Cowen opined "I do not see how the same court that was willing to permit the pension fund's third party claims to go forward could reach the opposite result with respect to the Diacetyl Plaintiffs' own third party claims against Aaroma." The majority distinguished Emoral from Foodtown in that the Foodtown claims involved claims to pension funds protected by ERISA and that "…there is a federal interest in supporting disregard of the corporate form to impose liability."

The conflict between the majority and dissenting opinions exposes a philosophical question related to claims related to insolvency proceedings- are creditors better served by permitting the pursuit of individual claims based at least in part on generalized theories of liability? Regardless of your philosophy, it appears the answer lies in the emphasis of the nature of the claim. If a creditor wishes to pursue a claim against a third-party outside of a bankruptcy proceeding, then creditor should emphasize the genesis of its claim and it particularized nature, while those seeking to defeat the creditors' standing will want to emphasize the creditor's necessity to utilize a legal theory of general liability such as successor liability or piercing the corporate veil. Those future legal battles will be fought within the boundaries drawn by the court's decision in Emoral.

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