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Article III and Bankruptcy Code Standing: Preserving a Party's Right to Object to a Proposed Reorganization Plan

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Introduction

In a chapter 11 bankruptcy proceeding, a troubled company can either restructure or liquidate through a confirmed chapter 11 plan. To encourage more participation in reorganization cases, courts have broadly interpreted section 1109(b) of the Bankruptcy Code, which determines who may object to a plan.[1] Section 1109(b) states that "a party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter." [2] A party wishing to object to a plan must also satisfy Article III standing, which courts have held is "effectively coextensive" with the party in interest standard under section 1109(b).[3] Mainly, parties wishing to object must demonstrate sufficient injury. The Third Circuit recently clarified the Article III sufficient injury requirement and stated that a party "must demonstrate an injury in fact that is concrete, distinct and palpable, and actual or imminent."[4]

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[1] *In re Global Indus. Technologies, Inc.* 645 F.3d 201, 211 (3d Cir. Pa. 2011).
[2] 11 U.S.C. §1109(b).
[3] *In re Global Indus. Technologies, Inc.,* 645 F.3d at 211.
[4] *Id.*

Recently, in *In re W.R. Grace*, the Third Circuit denied a party's objection to a proposed reorganization plan because the court held that the party lacked standing under Article III. The party in *In re Grace* hoped to assert contribution and setoff rights by demonstrating standing based on its substantial asbestos-related liability in connection with manufacturing and distributing construction chemicals. As stated above, courts require a party wishing to object to a plan to satisfy Section 1109(b)'s "party in interest" requirement and traditional Article III standing since the two are coextensive.[5] Therefore, a party must demonstrate sufficient injury. The court noted that the party's alleged injury was contingent on events that may never occur, therefore making it more "conjectural or hypothetical" than "actual or imminent."[6] The court found that the possibility of future personal injury claims did not satisfy standing because the party would not be entitled to contribution or set off claims unless those future lawsuits procured judgments or settlements.

This Article is separated into three parts. Part I discusses basic Constitutional and bankruptcy standing requirements. Part II discusses the holding in *In re W.R. Grace* and how the Third Circuit distinguished *In re W.R. Grace* from a previous ruling. Part III discusses future issues likely to arise from the *W.R. Grace* decision.

I. A Party Seeking to Object to a Reorganization Plan Must Satisfy Article III Standing and Section 1109(b)'s "Party in Interest" Standard

The Supreme Court has repeatedly recognized that before a federal court can exercise its judicial power over any dispute, there must be a justiciable case or controversy as required by Article III. [7] The Court noted, "[s]imply stated, a case is moot when the issues presented are no

[5] *Id*.
[6] *In re W.R. Grace & Co.,* 532 Fed.Appx. 264, 266-267 (3d. Cir. 2013)
[7] *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 590 (1992); *Friends of the Earth, Inc. v. Laidlaw Environmental Services (TOC), Inc.,* 528 U.S. 167, 212 (2000) ; *Allen v. Wright,* 468 U.S. 737, 751 (1984).

longer 'live' or the parties lack a legally cognizable interest in the outcome."[8] Courts use standing to determine whether a party has a protected interest in the matter and is entitled to be heard on particular issues.[9] In all federal cases, including bankruptcy proceedings, parties must satisfy Article III standing requirements.[10] Constitutional standing has three elements: (i) the plaintiff must have sustained an "injury in fact," that is "concrete," "distinct and palpable", and "actual or imminent"[11]; (ii) the injury must be traceable to the defendant's action, (i.e., there must be a causal connection between the two); and (iii) a ruling in favor of the plaintiff will likely redress the injury.[12] In many cases, issues may arise whether a party suffered an actual or imminent injury, or a conjectural or hypothetical injury.[13]

Although a party can have standing based on a future injury, that party must demonstrate that future injury is imminent.[14] For example, in *Lujan v. Defenders of Wildlife*, the Court stated that the plaintiffs' allegations of a possible future injury did not satisfy Article III's standing requirement.[15] In *Lujan*, the Court held that a party lacks standing if its alleged future injury stems from an indefinite risk of future harms inflicted by unknown third parties.[16] The Court found the plaintiff's proposed injury too speculative to establish the injury-in-fact requirement.

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[8] *Powell v. McCormack*, 395 U.S. 486, 496 (1969).
[9] *Elk Grove Unified Sch. Dist. V. Newdow,* 542 U.S. 1 (2004) (quoting *Warth v. Seldin,* 422 U.S. 490, 498 (1975)).
[10] *Danvers Motor Co. v. Ford Motor Co.,* 432 F.3d 286, 291 (3d Cir. 2005).
[11] *Whitmore v. Arkansas,* 495 U.S. 149, 155 (1990).
[12] *19 Court Street Assocs., LLC v. Resolution Trust Corp. (In re 19 Court Street Assocs., LLC*) 190 B.R. 983, 991 (Bailiff. S.D.N.Y. 1996) (citing *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 560-561, (1992)).
[13] *Lujan v. Defenders of Wildlife,* 504 U.S. at 590; *New Jersey Physicians, Inc. v. President of U.S.,* 653 F.3d 234 (2011); *Babbitt v. United Farm Workers Nat'l Union,* 442 U.S. 289, 298 (1979); *Whitmore v. Arkansas,* 495 U.S. at 155 (1990).
[14] *Lujan v. Defenders of Wildlife,* 504 U.S. at 560 ("[T]he plaintiff must have suffered an 'injury in fact'—an invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical.")
[15] *Id.* at 564.
[16] *Id.* at 564 n. 2.

However, courts have held that a future injury may satisfy Article III's standing requirement if certain circumstances arise.[17] For example, in *Reilly v. Ceridian Corp*., the Third Circuit held that a threatened injury might satisfy the standing requirement if it is certainly impending and will proceed with a high degree of immediacy.[18] In *Reilly,* a hacker breached a company's payroll database, which contained thousands of employee and client confidential information.[19] The plaintiffs claimed that they suffered from an increased risk of identity theft, increased credit monitoring expenses, and emotional distress.[20] However, the plaintiffs did not allege that the hacker read, copied or understood the confidential data.[21] The court stated that the imminence requirement ensures that courts do not entertain suits based on speculative or hypothetical terms.[22] The court held that since the plaintiff's allegations of increased risk of identify theft were hypothetical injuries. The court noted that although the plaintiffs have incurred expenses to protect their confidential information, they have not done so as a result of any *actual* injury since their private information has not been misused.[23] Since the alleged possible misuse is only speculative and not imminent, the plaintiff's alleged future harm is not sufficient to satisfy standing.[24]

The imminence requirement is also exemplified in *United States v. SCRAP*.[25] In *SCRAP,* an environmental interest group challenged the Interstate Commerce Commission's, ("ICC"), approval of a surcharge on railroad freight rates.[26] The plaintiffs claimed that the ICC's approval

[17] *Reilly v. Ceridian Corp.,* 664 F.3d 38, 42 (3d Cir. 2011).
[18] *Id.* at 42.
[19] *Id.* at 39.
[20] *Id.* at 40.
[21] *Id.* at 39.
[22] *Id*.
[23] *Id.* at 46 (quoting *Hammond v. Bank of N.Y. Mellon Corp.,* No. 08-6060, 2010 WL 2643307, at 4 (S.D.N.Y. June 25, 2010).
[24] *Id.*
[25] *U.S. v. Students Challenging Regulatory Agency Procedures (SCRAP),* 412 U.S. 669 (1973).
[26] *Id.* at 669.

would cause the group members to suffer "economic, recreational, and aesthetic harm."[27] Plaintiffs claimed that the general rate increase would cause an increase in the use non-recycle commodities, thus resulting in an increase of natural resources used to produce those goods, some of which might be taken from the Washington area and thus resulting in more refuse that might be discarded in Washington national parks.[28] The Court found that these alleged future injuries demonstrated a specific and perceptible harm sufficient to survive a motion to dismiss for lack of standing. The Court relied in part on prior decisions[29], where the court conferred standing when the alleged harm caused the party "injury in fact", and that the alleged injury was "arguably within the zone of interests to be protected or regulated" by the statutes that the agencies were claimed to have violated.[30] In *SCRAP,* the court noted that the "injury in fact" requirement is not confined to economic injury.[31] Therefore, the party's alleged future harm to their use and enjoyment of natural resources was sufficient to survive a motion to dismiss for lack of standing.

a. Parties Wishing to Object Must Also Satisfy Section 1109(b)'s "Party in Interest" Standard

Standing in bankruptcy cases is also governed by section 1109(b) of the Bankruptcy Code since courts have found that section 1109(b) and Article III are effectively coextensive.[32] Section 1109(b) provides that "a party in interest . . . may raise and may appear and be heard on any issue in a case under this chapter."[33] The Seventh Circuit has adopted the "party in interest" test to determine whether a party has a legally protected interest that could be affected by a

[27] *Id.* at 678.
[28] *Id.* at 689.
[29] *Association of Data Processing Service v. Camp,* 397 U.S. 150; *Barlow v. Collins*, 397 U.S. 159.
[30] *US v. Students Challenging Regulatory Agency Procedures (SCRAP)* 412 U.S. at 868.
[31] *Id.*
[32] *In re Global Indus. Technologies,* 645 F.3d at 210.
[33] 11 U.S.C. §1109(b); *In re Global Indus. Technologies, Inc.,* 645 F.3d at 6.

bankruptcy proceeding.[34] The Seventh Circuit determined the "party in interest" test comports with section 1109(b)'s "party in interest" definition since both determine an individual who "has a sufficient stake in the proceedings so as to require representation."[35]

Additionally, section 1128(b) of the Bankruptcy Code provides that "a party in interest may object to confirmation of a plan."[36] The court noted that if a party is deemed a party in interest, then it may object to a plan, provided that party satisfied the constitutional standing requirements discussed above.[37]

II. The Third Circuit in *In re W.R. Grace* Rejected A Party's Objection to a Reorganization Plan Because Article III Standing Was Not Satisfied

In *In re W.R. Grace*, a company, Garlock Sealing Technologies, LLC ("Garlock"), wished to object to another company's proposed reorganization plan because it alleged that if the Bankruptcy Court approved the plan, then the company would not be able to assert contribution rights. W.R. Grace & Co.'s ("Grace") filed for chapter 11 bankruptcy protection after being threatened by numerous asbestos-related personal injury lawsuits.[38] Since Garlock often purchased materials from Grace, the two companies were named as co-defendants in thousands of personal injury lawsuits.[39] Garlock objected to Grace's reorganization plan, alleging that as a former, current, and potential co-defendant, it had suffered injury because its contribution rights would be denied under the plan.[40] The Third Circuit affirmed the district court's ruling and held

[34] *In re James Wilson Associates,* 965 F.2d 160, 169 (7th Cir. 1992).
[35] *In re Amatex Corp.,* 755 F.2d 1034, 1042 (3d Cir. 1985).
[36] 11 U.S.C. §1128(b).
[37] *Southern Blvd. Inc. v. Martin Paint Stores (In re Martin Paint Stores)*, 207 B.R. 57, 61 (Bank. S.D.N.Y. 1997) (citing *In re James Wilson Assocs.,* 965 F.2d 160, 169 (7th Cir. 1992)).
[38] *Id.*
[39] *Id.*
[40] *In re W.R. Grace & Co*., 475 B.R. 34, at 177 (2012).

that Garlock did not have standing to object to Grace's proposed chapter 11 plan of reorganization.[41]

The Third Circuit, however, ruled that Garlock's future claims against Grace were insufficient to establish Article III standing because they were entirely speculative. In particular, the court found that Garlock failed to introduce any evidence that it ever sought contribution from Grace, impled Grace in any previous action, or suffered any judgment that would have entitled Garlock to assert contribution or setoff rights.[42] Furthermore, the court noted that Garlock had not even filed a claim in Grace's bankruptcy case.[43] For Garlock to have standing to assert contribution claims, the plaintiffs in the personal injury lawsuits must either win or settle their cases, thereby giving rise to a contribution claim against Grace. The court determined that that Garlock's alleged injury was contingent on plaintiff verdicts or settlements, which made it more conjectural or hypothetical than actual or imminent, especially given that no such contribution claims had ever been asserted notwithstanding the thousands of ongoing cases involving Grace and Garlock.[44]

a. The Third Circuit Distinguished *In re W.R. Grace* From *In re Global Industries Technologies* Because Garlock's Injury Was Not Sufficiently Imminent

The Third Circuit in *In re W.R. Grace* distinguished it's ruling from a previous case *In re Global Industrial Technologies.* In *In re Global Industrial Technologies,* the district court held that the plaintiff, an insurance company, satisfied the standing requirements under Article III and section 1109 and therefore could object to a proposed reorganization plan even though the alleged injury to the insurance had not yet occurred.[45] On appeal, the Third Circuit determined

[41] *In re W.R. Grace & Co.,* 532 Fed.Appx. at 264.
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *In re Global Indus. Technologies, Inc.,* 645 F.3d at 201.

that the Article III injury-in-fact requirement and section 1109(b) must be construed broadly.[46] Additionally, the Third Circuit stated that Article III standing requirements and the Bankruptcy Code are "effectively coextensive."[47] The Third Circuit found that the plaintiff's contingent claims were sufficiently imminent because the proposed plan increased the number of claims against the plaintiffs significantly. In this case, the plaintiff's claims increased by twenty-nine times the original amount. The increase in potential claims coupled with increasing administrative costs drove the Third Circuit's decision to rule that the plaintiffs satisfied the injury-in-fact requirement by showing an actual and imminent injury and therefore had standing to object. The Third Circuit dissent noted that the expansion from parties who suffered an actual injury to those that *may* suffer injury from the plan will potential open the litigation floodgates to those persons who may seek to obtain a party in interest standing by alleging a fear that future business dealings with the reorganized company may result in less profits than expected.[48]

III. Implications from *W.R. Grace* and Preserving a Party's Right to Assert a Contingent Claim

W.R. Grace follows the well-established rule that a party must have Article III standing in order to object in a bankruptcy case. *W.R. Grace* reinforces that Article III requires a specific and actual injury. If an objecting party has not asserted a claim for contribution in the past, then it has not suffered an actual injury. Even though there were thousands of claims pending against Grace and Garlock, the mere possibility of future injury was not enough for Article III standing because potential injury was only hypothetical. Notwithstanding the court's ruling, it is still possible that Garlock may suffer an actual injury arising from the pending lawsuits, but at that point it will be too late because the court will likely have already approved the reorganization plan.

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[46] *Id at* 211.
[47] *Id.*
[48] *Id*.

Ultimately, it is important to note that the Third Circuit's decision relied heavily on the facts that (1) Garlock had never sought contribution against Grace despite the thousands of lawsuits against both that had been ongoing for over a decade and (2) Garlock had never filed a proof of claim in Grace's bankruptcy case. *W.R. Grace* demonstrates that while the mere filing a proof of claim will not create standing, a court will consider a party's failure to do so as evidence that that party lacks standing to participate in the bankruptcy case. Therefore, if a party wants to preserve its rights to assert a contingent claim, that party should at the very least file a proof of claim asserting the contingent claim.

Bankruptcy and non-bankruptcy cases demonstrate that the federal courts will refuse to hear a party if the party has not suffered an appropriate injury. Therefore, parties should air on the side of caution and take preventative steps to insure that they had a satisfactory injury. In bankruptcy cases, while the mere filing a proof of claim will not create standing, a court will consider a party's failure to do so as evidence that that party lacks standing to participate in the bankruptcy case.[49] Therefore, if a party wants to preserve its rights to assert a contingent claim, that party should at the very least file a proof of claim asserting the contingent claim.

IV. Conclusion

A party must satisfy Article III and Bankruptcy Code requirements in order to object to a debtor's plan of reorganization or participate in the debtor's bankruptcy case generally. In sum, a party must show that it has suffered a cognizable injury that would entitle the party to be heard on the issue. Federal courts are hesitant to hear objections from party's who have not yet suffered an injury or when injury is not sufficiently imminent.

A party seeking to participate in the debtor's bankruptcy case should file a proof of claim asserting the party's contingent claim against the debtor in order to increase the likelihood that

[49] *In re W.R. Grace & Co,* 532 Fed.Appx. at 265.

the federal court will permit the party to participate. Although filing will not, by itself, confer standing on the party, the court will view the filing as evidence that the party faces an imminent injury that is caused by the debtor.