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Third Circuit Adopts Standard for Appointment of Future Claimants Representatives

The court's decision in* In re Imerys Talc America, Inc. *clarifies the appointment standard for future claimants representatives in the Third Circuit under Section 524(g) of the US Bankruptcy Code.

In a precedential decision, the US Court of Appeals for the Third Circuit upheld the appointment of James L. Patton, Jr. as the legal representative for future talc claimants (FCR) by the bankruptcy court in the Imerys Talc America chapter 11 cases.[1]

Resolving a split among lower courts, the Third Circuit adopted a heightened fiduciary standard for the appointment of FCRs in lieu of the "disinterestedness" standard applicable to chapter 11 professionals. Notably, however, the Third Circuit declined to prescribe any particular process for a bankruptcy court to follow in appointing an FCR.

Latham represents the Imerys Talc America entities in the appeal and is also counsel to the debtors in the chapter 11 cases.

Background

Imerys Talc America, together with its North American affiliates (collectively, ITA), previously specialized in the production and supply of talc in the North American market. In 2019, faced with mounting talc-related litigation liabilities, ITA initiated chapter 11 proceedings in the US Bankruptcy Court for the District of Delaware to pursue a plan of reorganization to permanently resolve its talc-related liabilities (including asbestos-related claims) pursuant to Sections 524(g) and 105(a) of the Bankruptcy Code. Section 524(g) requires that an FCR be appointed by the bankruptcy court to represent the interest of future claimants in plan negotiations.

In 2018, ITA engaged James L. Patton, Jr. as proposed FCR to represent the interests of future talc claimants in a potential chapter 11 filing. Once ITA initiated the chapter 11 cases, it moved to have Mr. Patton officially appointed as FCR by the Bankruptcy Court. In May 2019, over the objection of some of ITA's historical insurers, the Bankruptcy Court issued an order appointing Mr. Patton as FCR.

Several historical insurers appealed the Bankruptcy Court's order appointing Mr. Patton as FCR. The insurers argued that Mr. Patton was conflicted from serving as FCR in the ITA bankruptcy because his

law firm represented two of the insurers in an unrelated insurance coverage dispute that also involved asbestos liabilities. The insurers pivoted to this conflict argument in the Bankruptcy Court after unsuccessfully objecting to Mr. Patton's appointment based on his prepetition engagement by the debtors as proposed FCR. As the first level of review, the US District Court for the District of Delaware denied the insurers' arguments and affirmed the Bankruptcy Court's order appointing Mr. Patton. The insurers appealed to the Third Circuit.

FCR Appointment Affirmed

Firmly rejecting the insurers' arguments, the Third Circuit was satisfied that the Bankruptcy Court gave due consideration to the purported conflict in the course of Mr. Patton's appointment and reasonably determined that no disqualifying conflict existed. Specifically, after requesting additional disclosures from Mr. Patton regarding his firm's other representation, the Bankruptcy Court found that the insurers' prospective conflict waiver (which specifically envisioned that Mr. Patton's firm would represent other clients in Section 524(g) bankruptcy proceedings), coupled with the fact that Mr. Patton and his FCR team were walled off from the firm's insurance litigation matters, provided adequate assurance that Mr. Patton could faithfully serve as a fiduciary for future claimants without divided loyalties.

The Third Circuit also rejected the insurers' argument that the ITA bankruptcy and the other asbestos-related matters handled by Mr. Patton's firm were "substantially related" because they both involved insurance coverage disputes — calling this assertion "vague" and unsupported.[2]

Standard for FCR Appointments

The Third Circuit's decision clarifies the standard for appointment of FCRs under Section 524(g)(4)(B) of the Bankruptcy Code. Specifically, the court held that an FCR must be able to "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."[3]

In so holding, the Third Circuit declined to adopt the "disinterestedness" standard applicable to chapter 11 professionals, finding that an FCR's statutory mandate as a "legal representative" for future claimants requires it to "fulfill the heightened duties owed by fiduciaries."[4] The fiduciary standard adopted by the Third Circuit is similar (though not identical) to the guardian *ad litem* standard utilized in other contexts and is consistent with the standards governing creditors' committees in bankruptcy proceedings.

The Third Circuit also addressed the role of the bankruptcy court in addressing purported conflicts of interest. The court stressed that "*whether* a conflict exists is less relevant to an [FCR] appointment than the nature of the conflict and importance of the conflict to the future claimants' interests."[5] The court emphasized that a conflict with a "minimal or no impact on an FCR's ability to successfully represent the future claimants' interests[]" should likely not preclude appointment.[6] The Third Circuit noted that even a conflict under Rule 1.7 of the Model Rules of Professional Conduct (assuming, without deciding, that those rules apply to FCRs) may not be sufficient to disqualify an otherwise qualified FCR; that too is left to the discretion of the bankruptcy court.

Finally, the Third Circuit declined to mandate any particular process for the bankruptcy court to follow in making FCR appointments. The only "procedural requirement" is that the bankruptcy court receive "the information necessary to assess the candidate(s)'s qualifications."[7]

Insurers Lack Generalized Standing

While the Third Circuit ultimately reached the merits of the appeal, it found that only two of the insurers were actually involved in the firm's previous coverage litigation and therefore had standing to raise the alleged conflict of interest.

The Third Circuit reaffirmed its earlier holding in *Travelers Insurance Co. v. H.K. Porter Co., Inc.*[8] that standing in bankruptcy appeals is limited to "person[s] aggrieved" — a standard parties meet when a contested order "diminishes their property, increases their burdens, or impairs their rights."[9]

The court rejected the remaining insurers' arguments for standing based on an asserted generalized interest in the "integrity of the bankruptcy process."[10] The remaining insurers could not bypass the "person[s] aggrieved" standard absent a clear need to expand the pool of those with standing to raise the alleged conflict. In so holding, the court observed that the insurers' objection appeared to be a "tactical one to delay Imerys's plan confirmation," and was the sort of "bad-faith tactic" that the Third Circuit has previously guarded against in the standing context.[11]

If you have questions about this Client Alert, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Jeff Bjork
jeff.bjork@lw.com
+1.213.891.8872
Los Angeles

Roman Martinez
roman.martinez@lw.com
+1.202.637.3377
Washington, D.C.

Kimberly A. Posin
kim.posin@lw.com
+1.213.891.7322
Los Angeles

Helena Tseregounis
helena.tseregounis@lw.com
+1.213.891.7698
Los Angeles

Deniz A. Irgi
deniz.irgi@lw.com
+1.213.891.8023
Los Angeles

Endnotes

[1] *In re Imerys Talc America, Inc., et al. v. Cyprus Historical Excess Insurers*, No. 20-3485 (3d Cir. June 30, 2022).

[2] *Id.* at 30.

[3] *Id.* at 19.

[4] *Id.* at 22.

[5] *Id.* at 25.

[6] *Id.* at 25-26.

[7] *Id.* at 27.

[8] *Travelers Insurance Co. v. H.K. Porter Co., Inc.*, 45 F.3d 737 (3d Cir. 1995) (citation omitted).

[9] *In re Imerys Talc America.*, No. 20-3485 at 12-13.

[10] *Id.* at 12.

[11] *Id.* at 14.