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7th Circ. Ruling Shows Value Of Thorough Debtor Notices

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In recent years, companies and other large organizations have increasingly turned to Chapter 11 proceedings as an option to manage mass tort liability.

A critical question in these cases will be how the debtors should provide notice to potential claimants.

As in any Chapter 11 case, companies enter into these proceedings with the goal of resolving their liabilities as comprehensively as possible.

In this regard, the issue of notice to claimants plays an essential role because claimants must receive adequate notice to be bound by any orders in the debtor's Chapter 11 proceedings—including any discharge that the debtor receives at the end of those proceedings.[1]

That is not to say that a debtor must specifically notify every single potential creditor to receive a discharge. On the contrary, it is entirely possible for a Chapter 11 case to discharge both known and unknown creditors' claims.

The key distinction, however, is the extent of the debtor's notice obligations, which vary for known versus unknown creditors.

Typically, if a creditor's identity is known to or reasonably ascertainable by the debtor, then the debtor must provide actual written notice to that creditor.[2] This requirement is strict and applies even to creditors who already know about the debtor's bankruptcy proceedings.[3]

In contrast, constructive notice, e.g., notice by publication, generally suffices for an unknown creditor—one whose interests are conjectural or future, or whose identity, while discoverable in theory, "do[es] not in due course of business come to knowledge" of the debtor.[4]

While these principles sound straightforward, applying them to bankruptcies involving mass tort liabilities can be

difficult. Setting aside obviously known creditors, such as those who have actually initiated litigation, how can a debtor determine where its obligations of actual notice begin and end?

A debtor may find itself aware of the existence of large numbers of potential claimants, but unable to readily determine the identities of those claimants—if their identities can even be determined at all. Debtors may also wonder how to ensure that notices to unknown, or semi-known, creditors satisfy their obligation to provide notice that is reasonably calculated to reach all interested parties.[5]

A recent U.S. Court of Appeals for the Seventh Circuit opinion addresses these issues in the context of a case involving mass tort liabilities, providing helpful guidance for practitioners confronting these questions. The debtor organization in In re: USA Gymnastics[6] sought Chapter 11 relief in 2018.[7]

As the court noted, Larry Nassar, a physician formerly employed by the debtor, had sexually assaulted "hundreds" of claimants, including one of the parties to the Seventh Circuit appeal.[8]

She sought to file a claim late—about five months after the bar date.[9] Although she had not received actual notice of the proceedings, the bankruptcy court nonetheless concluded that she was bound by the bar date order and rejected her claim.[10]

The Seventh Circuit affirmed the bankruptcy court's determination.[11] Applying the principles described above, the court explained that constructive notice sufficed for this claimant because her identity had not been reasonably ascertainable to the debtor.[12]

To determine whether her identity had been reasonably ascertainable, the court looked to whether the debtor could have uncovered her identity using reasonably diligent efforts.[13] Here, the court found it significant that the claimant could not point to any evidence that the debtor possessed medical documentation of her interactions with Nassar.[14]

The Seventh Circuit also rejected the claimant's arguments that the debtor had been obligated, under a state recordkeeping statute, to maintain such documentation, concluding that the statute cited by the claimant simply did not apply.[15] Based on these facts, the Seventh Circuit concluded that the claimant's identity had not been reasonably ascertainable to the debtor, and thus had been entitled to constructive notice only.[16]

Even though the appellant's claim in In re: USA Gymnastics came only a few months late, the court nonetheless concluded that the bankruptcy court had properly rejected her claim. The court also declined to increase the debtor's burden to investigate the identities of its potential claimants beyond well-established standards.

At bottom, the court found it dispositive that the debtor neither possessed nor should have possessed medical records that would have indicated the potential claimant's identity. This relatively bright line should provide guidance to practitioners evaluating notice obligations in other cases.

It is also worth noting what the Seventh Circuit's opinion did not address. As the final sentence of the opinion highlights, the appellant in In re: USA Gymnastics did not challenge the sufficiency of the constructive notice that the debtor had given.

Yet even though the sufficiency of that notice was outside the scope of the claimant's appeal, the court nonetheless went out of its way to describe the debtor's extensive efforts to notify potential claimants of the proceedings—including "email[ing] copies of the notice to more than 360,000 current and former members of the organization" and "plac[ing] information about the bar date on its website, its social media pages, in USA Today, and in gymnastics journals, podcasts, and websites."[17]

For practitioners, the takeaway is clear: The more comprehensive and thorough the debtor's notice efforts, the easier it will be for courts to enforce the bankruptcy court's orders later on.

For example, the following factors could affect the adequacy of a debtor's notices:

- The debtor's specific selection of media sources for the publication of notices, including whether the debtor has used less traditional media sources, like social media and podcasts, under appropriate circumstances;
- The debtor's use of any of its business records that might help to identify claimants;
- The debtor's use of email and other forms of electronic communication to spread the word widely to large numbers of potential claimants;
- The extent to which the debtor has complied with any record-keeping obligations under nonbankruptcy law and whether any noncompliance has interfered with the debtor's ability to identify its claimants; and
- The debtor's use of interest-, industry- or location-specific media sources to publish notices that its potential claimants are especially likely to encounter.

Conversely, if a debtor's notice efforts are not consistent with these principles, claimants may find greater success in efforts to escape the impact of the bankruptcy court's orders.

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[1] See, e.g., Chemetron Corp. v. Jones, 72 F.3d 341 (3d Cir. 1995).

[2] Id. at 346.

[3] City of New York v. New York, N. H. & H. R. Co., 344 U.S. 293, 297, (1953) ("[E]ven creditors who have knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred.").

[4] Chemetron Corp., 72 F.3d at 346.

[5] Id. (quoting Greyhound Lines, Inc. v. Rogers (In re Eagle Bus Mfg., Inc.), 62 F.3d 730, 735 (5th Cir. 1995)).

[6] No. 21-2916, 40 F. 4th. 775, 2022 WL 2800076 (7th Cir. 2022).

[7] Id. at 777.

[8] Id. at 776.

[9] Id.

[10] Id.

[11] Id.

[12] Id. at 778.

[13] Id.

[14] Id.

[15] Id.

[16] Id.

[17] Id. at 777.

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