By Scott A. Wolfson and Thomas J. Kelly

The Moral of *Emoral*: Expanding Trustee Standing

Scott A. Wolfson
Wolfson Bolton PLLC
Troy, Mich.

Thomas J. Kelly
Wolfson Bolton PLLC
Troy, Mich.

Scott Wolfson is a member and Thomas Kelly is an associate with Wolfson Bolton PLLC in Troy, Mich.

The Third Circuit Court of Appeals held in *In re Emoral*[1] that a creditor's successor-liability claim against a nondebtor/third party constituted property of the bankruptcy estate, even though the claim arose from personal injuries allegedly committed by the debtor. As property of the estate, only the trustee could assert the claim against the third party, leaving the injured creditors to recover solely from the debtor's estate or other defendants.[2]

The decision conflicts with the Bankruptcy Code by expanding trustee standing to assert creditors' claims where the debtor is uninjured. Under 11 U.S.C. § 541, a trustee has standing to assert causes of action that belong to the debtor.[3] For a cause of action to belong to the debtor, the debtor must have been, at the very least, injured.[4] In successor-liability actions, however, the corporate debtor is uninjured. Instead, injured plaintiffs seek to hold a third-party successor corporation liable for the debtor corporation's debts. Without an injury to the debtor corporation itself, a trustee should not have standing to assert a successor-liability claim.

Background

Emoral Inc. manufactured and sold synthetic flavors and fragrances.[5] The company was a leading manufacturer of diacetyl, a food additive that was most commonly used in artificial butter flavoring for popcorn.

Emoral sold certain assets and assigned certain liabilities to Aaroma Holdings LLC in August 2010. At the time of the transaction, Emoral and Aaroma were aware of potential personal injury claims arising from individuals' exposure to diacetyl. These individuals became known as the "diacetyl plaintiffs."[6] The sale specifically excluded Aaroma's assumption of any liabilities related to the diacetyl plaintiffs' claims.

Emoral filed for chapter 7 relief in the U.S. Bankruptcy Court for the District of New Jersey in June 2011. During the bankruptcy, the chapter 7 trustee asserted a fraudulent transfer claim against Aaroma relating to Emoral's prebankruptcy transfer of assets to Aaroma. The parties settled, and Aaroma agreed to pay the bankruptcy estate $500,000 in exchange for a release of all causes of action against it that were property of the bankruptcy estate.[7]

After the trustee settled his claims against Aaroma, the diacetyl plaintiffs sued Aaroma in New Jersey state court alleging that Aaroma, as a successor to and mere continuation of Emoral, was liable for their injuries.[8] Aaroma filed a motion with the bankruptcy court seeking to enforce the settlement agreement.[9] Aaroma asserted that the diacetyl plaintiffs' claims were property of the estate, thus properly brought only by the trustee, who had already released the claims.

The bankruptcy court denied Aaroma's motion.[10] Following Third Circuit precedent, the bankruptcy court held that only those claims alleging an injury general to all creditors were property of the estate. The court explained that the diacetyl plaintiffs' personal injury claims alleged particular, rather than general, injuries. As particular injuries, the claims fell outside the scope of the estate and could be brought only by the diacetyl plaintiffs themselves.

On appeal, the U.S. District Court for the District of New Jersey reversed.[11] The district court focused on the diacetyl plaintiffs' successor-liability theory against Aaroma, rather than on their personal-injury claims against Emoral. Unlike the personal injury claims, the successor-liability claim — the only claim establishing Aaroma's liability — arose from facts common to all creditors. The district court stated that "the critical distinction between the personal injury claim against Emoral and the successor-liability claim against Aaroma is that establishing the former would benefit only the allegedly injured Diacetyl Plaintiffs, whereas establishing the latter ... would benefit creditors of Emoral generally."[12] Because establishing

1 740 F.3d 875 (3d Cir. 2014).
2 *Id.* at 882.
3 *See* 5 *Collier on Bankruptcy* ¶ 541.07 (Alan N. Resnick and Henry J. Sommer eds., 16th ed.) ("The estate created pursuant to section 541(a) includes causes of action belonging to the debtor at the time the case is commenced.").
4 Article III standing requires an injury that was in fact caused by the defendant that can be redressed by the court. *Vt. Agency of Natural Res. v. U.S. ex rel. Stevens*, 529 U.S. 765, 771 (2000).
5 *Emoral*, 740 F.3d at 877.
6 *Id.*
7 The diacetyl plaintiffs were concerned that their claims against Aaroma might be released by the settlement agreement, which released all claims against Aaroma that were property of the estate. *Id.* However, the trustee indicated his belief that the diacetyl plaintiffs' claims were not property of the estate. His representative made the following statement at the bankruptcy court hearing: "I would like to sell someone the Brooklyn Bridge, but I don't own it so I can't sell it. I cannot, the Trustee cannot release claims that he doesn't own. It was never contemplated that he would be releasing claims he doesn't own." *Id.* at 877 n.1.
8 *Id.* at 877.
9 *Id.* at 877-78.
10 *Id.* at 878.
11 *Id.*
12 *Id.*

Aaroma's successor liability would benefit all creditors, the district court held that the diacetyl plaintiffs' claim against Aaroma was property of the estate.

Third Circuit: Successor Liability Claims Are Property of the Estate

The Third Circuit Court of Appeals affirmed the district court in a 2-1 opinion.[13] Once a company files for bankruptcy, "creditors lack standing to assert claims that are property of the estate."[14] The "estate," as defined in the Bankruptcy Code, includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[15] This includes causes of action that are considered property of the estate "if the claim existed at the commencement of the filing and [if] the debtor could have asserted the claim on his own behalf under state law."[16] If a claim is a "general one with no particularized injury arising from it," it is property of the estate.[17] On the other hand, if a claim is specific to a creditor, with no other creditors generally having an interest in the claim, it is not property of the estate.[18] The bankruptcy trustee is the proper party to assert general claims because such claims "inure ... to the benefit of all creditors,"[19] which "promotes the orderly distribution of assets in bankruptcy, and comports with 'the fundamental bankruptcy policy of equitable distribution to all creditors that should not be undermined by an individual creditor's claim.'"[20]

In determining whether the diacetyl plaintiffs' successor-liability claim against Aaroma was general or individualized, the Third Circuit disregarded the diacetyl plaintiffs' personal injury claims against Emoral. According to the court, the diacetyl plaintiffs' "only theory of liability as against Aaroma, a third party that is not alleged to have caused any direct injury to the Diacetyl Plaintiffs, is that, as a matter of state law, Aaroma constitutes a 'mere continuation' of Emoral such that it has also succeeded to all of Emoral's liabilities."[21] Nothing about the "factual allegations that would establish their cause of action based on successor liability [were] unique to them as compared to other creditors of Emoral."[22] Further, any recovery under such a claim would benefit all creditors of the estate, not just the diacetyl plaintiffs. Thus, the diacetyl plaintiffs' claims were held to be property of the estate because the claims were "based on facts generally available to any creditor, and recovery would serve to increase the pool of assets available to all creditors."[23]

13 *Id.* at 876.
14 *Id.* at 879 (quoting *Bd. of Trustees of Teamsters Local 863 Pension Funds v. Foodtown Inc.*, 296 F.3d 164, 169 (3d Cir. 2002)).
15 *Id.* (quoting 11 U.S.C. § 541(a)(1)).
16 *Id.* (quoting *Foodtown*, 296 F.3d at 169 n.5).
17 *Id.* (quoting *Foodtown*, 296 F.3d at 170).
18 For other circuits following the general/particular distinction, *see City Sanitation LLC v. Allied Waste Servs. of Mass. LLC (In re Am. Cartage Inc.)*, 656 F.3d 82, 90 (1st Cir. 2011); *St. Paul Fire & Marine Ins. Co. v. PepsiCo Inc.*, 884 F.2d 688, 701 (2d Cir. 1989); *Schimmelpenninck v. Byrne (In re Schimmelpenninck)*, 183 F.3d 347, 359 (5th Cir. 1999); *Koch Refining v. Farmers Union Cent. Exch. Inc.*, 831 F.2d 1339, 1348-49 (7th Cir. 1987); *Baillie Lumber Co. v. Thompson*, 391 F.3d 1315, 1321 (11th Cir. 2004).
19 *Emoral*, 740 F.3d at 879.
20 *Id.* (quoting *Koch Refining*, 831 F.2d at 1344).
21 *Id.* The mere continuation theory of successor liability under New York and New Jersey state law requires "continuity in management, shareholders, personnel, physical location, assets and general business operation between selling and purchasing corporations following the asset acquisition." *Id.* at 880 (citation omitted).
22 *Id.* at 880.
23 *Id.* at 881.

Dissent

In his dissent, Hon. Robert Cowen asserted that the diacetyl plaintiffs' claims were not property of the estate because they "could not be brought by any creditor of the debtor."[24] He began by noting, in agreement with the majority, that "the underlying personal injury claims against Emoral are individualized in nature."[25] Yet, unlike the majority, Judge Cowen reasoned that "[t]he 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."[26] The fact that the diacetyl plaintiffs were seeking to hold Aaroma liable under a successor-liability theory for personal injuries caused by Emoral did not mean that their claims were general to all creditors rather than individualized to the diacetyl plaintiffs. Any creditor of the debtor, such as a trade creditor, "could not allege that the third party should be held responsible on this specific theory of successor liability for injuries allegedly suffered as a result of exposure to a product made and sold by the debtor itself."[27] Therefore, Judge Cowen would have held that the diacetyl plaintiffs' cause of action against Aaroma was not property of the estate.

Trustee Standing to Assert Successor Liability Claims under the Code

Whether the Third Circuit properly characterized successor-liability claims as general rather than particular is debatable. The dissent in Emoral makes a strong argument that the successor-liability claim is inextricably tied to the diacetyl plaintiffs' personal-injury claims. However, a more fundamental problem underlies the Third Circuit's decision: Section 541 does not grant a trustee standing to assert creditors' claims when the debtor is uninjured.[28]

In reaching its decision, the Third Circuit relied on § 541(a)(1), which defines "property of the estate" as "all legal or equitable interests of the debtor in property as of the commencement of the case." The scope of § 541 is intentionally broad and includes "choses in action and claims by the debtor against others."[29] Similar to avoidance actions, only the trustee has standing to bring claims that are property of the estate.

Section 541 limits "property of the estate" to the *debtor's* interests in property, not the creditors' interests. Therefore, the debtor must have been injured for the debtor to have an interest in the claim. Most courts applying the general/particular distinction, either explicitly or implicitly, have held that the debtor must have been injured for a cause of action to be considered estate property. For example, the Seventh Circuit Court of Appeals in *Koch Refining* held that an alter-ego claim asserted by creditors against a corporate debtor and

24 *Id.* at 883 (Cowen, J., dissenting).
25 *Id.*
26 *Id.*
27 *Id.*
28 *See, e.g., Spartan Tube & Steel Inc. v. Himmelspach (In re RCS Engineered Prods. Co.)*, 102 F.3d 223, 225-26 (6th Cir. 1996) (holding that trustee of subsidiary corporate debtor has no standing under Michigan law to assert alter-ego claim against subsidiary's parent or shareholders).
29 S. Rep. No. 95-989 (1978).

continued on page 68

from page 25

its shareholders constituted property of the estate because the creditors sought relief for an injury that was "general and common to the corporation and creditors."[30] The court held that "[t]he injury alleged by the oil companies, it can clearly be seen, is to the corporation directly and to the oil companies indirectly."[31]

In *St. Paul Fire & Marine*, the Second Circuit Court of Appeals also held that the trustee of a corporate debtor was the proper party to assert an alter-ego claim against the debtor's parent because the creditor seeking to assert the claim did "not have a particularized and direct injury."[32] While not explicitly stated, the Second Circuit's decision relied on the fact that the debtor was injured by the parent's misuse of the debtor's property.

However, the Third Circuit in *Emoral* did not focus on whether the corporate debtor was injured. Instead, the Third Circuit examined whether a successor-liability action arose out of facts that were generally available to all creditors and whether recovery would benefit all creditors. Such a rule is not suggested by § 541.

No other Code provision supports the Third Circuit's decision. In fact, the decision likely violates U.S. Supreme Court precedent. In *Caplin v. Marine Midland Grace Trust Co.*, the Supreme Court held that a trustee "does not have standing to sue an indenture trustee on behalf of debenture holders."[33] The Court reviewed the pre-1978 Bankruptcy Act and held that "nowhere in the statutory scheme is there any suggestion that the trustee in reorganization is to assume the responsibility of suing third parties on behalf of debenture holders."[34] At the conclusion of its opinion, the Court invited Congress to enact legislation that would permit a trustee to sue an indenture trustee on behalf of debenture holders. Although Congress responded by proposing 11 U.S.C. § 544(c), which would have granted standing to trustees to bring creditors' claims in general, the provision was never adopted.[35]

Conclusion

Emoral allows a trustee to assert creditors' successor-liability claims when the debtor is uninjured. As the Supreme Court recently denied *certiorari*, this questionable expansion of trustee standing will remain binding in the Third Circuit for the foreseeable future.[36] abi

30 831 F.2d at 1349.
31 *Id.*
32 884 F.2d at 707.
33 406 U.S. 416, 434 (1972).
34 *Id.* at 428.
35 Under the proposed 11 U.S.C. § 544(c), a trustee could have "enforce[d] any cause of action that a creditor or class of creditors ... ha[d] against a third party." C-4d *Collier on Bankruptcy III* (Alan N. Resnick and Henry J. Sommer eds., 16th ed.). The fact that Congress declined to adopt legislation overruling Caplin may indicate that Congress did not intend to grant standing to a trustee to assert general claims of creditors when the debtor is uninjured. *See, e.g., Williams v. Calif. 1st Bank*, 859 F.2d 664, 667 (9th Cir. 1988) ("We agree with the Eighth Circuit that Congress'[s] express decision not to overrule Caplin is 'extremely noteworthy.'" (citation omitted)).
36 *Diacetyl Plaintiffs v. Aaroma Holdings LLC*, 190 L. Ed. 2d 328 (2014).