

FROM FREE-FALL TO FREE-FOR-ALL: THE RISE OF PRE-PACKAGED ASBESTOS BANKRUPTCIES

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Asbestos litigation is a nationwide problem that has become intimately connected with bankruptcy law in the past several decades, and increasingly so in the past several years. As more and more companies facing asbestos liability seek the special protections bankruptcy offers them, the interest in swift resolution of enormous numbers of claims and rapid plan confirmation has resulted in pre-packaged asbestos bankruptcies that flout the provisions of the Bankruptcy Code, often at the expense of asbestos victims.

Since the landmark asbestos bankruptcy case, *In re Johns–Manville*, asbestos debtors have at once refined the mechanics, and strayed from the purpose, of the Bankruptcy Code and particularly of section 524(g), a provision that permits debtors and their affiliates to rid themselves of asbestos liability by channeling asbestos claims to a trust. In a sign that asbestos bankruptcy practice may have come full circle, on January 26, 2004 Judge Randall J. Newsome, of the Bankruptcy Court for the Northern District of California (but sitting as a visiting judge in Delaware), issued an opinion in *In re ACandS, Inc.*,¹ recommending that confirmation of the reorganization plan be denied.² Finding that the plan discriminated unfairly within and among classes of claims and that it was not proposed in good faith, and following a lengthy discussion of the disparate treatment of personal injury claimants and conflicting interests in negotiating the plan, Judge Newsome closed his opinion: "The court is informed that other judges have confirmed plans with such discriminatory classifications. This judge cannot do so in good conscience."³

Judge Newsome's opinion echoes the Second Circuit's in *Johns–Manville* a dozen years earlier in its insistence on adhering to the provisions of the Bankruptcy Code even at the expense of rejecting a plan to deal with the asbestos deluge. However, between *Johns–Manville* and *ACandS* are numerous asbestos cases in which the purpose and language of the Bankruptcy Code have been disregarded in favor of expediency. That expediency is rationalized as necessary to save the debtor company and compensate

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¹ 311 B.R. 36 (Bankr. D. Del. 2004). *ACandS* was filed as a conventional bankruptcy case after negotiations over a pre-packaged plan collapsed. Some of the more questionable practices typical of a pre-packaged plan, however, survived the collapse. For example, the proposed plan honored liens in insurance proceeds that had been granted to settling asbestos claimants during the pre-packaged negotiations. See *Objection to Certain Proposed Findings of Fact and Conclusions of Law Re: Chapter 11 Plan Confirmation Pursuant to Bankruptcy Rule 9033 and Mot. to Confirm Plan of Reorganization, In re ACandS, Inc.*, 311 B.R. 36 (Bankr. D. Del. 2004) (No. 02-12687) (discussing liens in potential insurance proceeds debtor granted to settling claimants pre-petition).

² See *Proposed Findings of Fact and Conclusions of Law Re: Chapter 11 Plan Confirmation at 12, In re ACandS, Inc.*, 311 B.R. 36 (Bankr. D. Del. 2004) (No. 02-12687) (denying confirmation of debtor's plan of reorganization).

³ *Id.*

asbestos victims. But by departing from the provisions of the Bankruptcy Code, the engineers of these cases too often compromise the rights of others, including the victims of asbestos exposure whose interests are not represented. These cases have also drawn the protests of insurers who argue that they are excluded from defending their contractual and statutory rights even as the parties negotiate with their funds.

I. BACKGROUND

It is conservatively estimated that by the end of 2000 more than 600,000 asbestos-related personal injury claims had been brought against approximately 8,400 companies.⁴ While through the 1980's, the typical asbestos lawsuit named twenty defendants, by the mid-1990's claimants were naming sixty to seventy defendants.⁵ The trend shows no sign of slowing. With over seventy asbestos producers and manufacturers of asbestos-containing products in bankruptcy (and with more likely to follow), plaintiffs name as defendants companies with increasingly remote connections to asbestos production.⁶ Likewise, as transaction costs associated with bringing asbestos claims decrease⁷ (due, in part, to courts' attempts to expedite handling of large numbers of claims and ease the burden on their dockets),⁸ the proportion of asbestos personal injury plaintiffs whose injuries are nonmalignant has grown over the past decade.⁹ Recent studies indicate that up to ninety percent of current asbestos claims are filed by unimpaired claimants.¹⁰

The first asbestos defendant filed for dissolution in 1978.¹¹ The landmark chapter 11 bankruptcy cases

⁴ See STEPHEN J. CARROLL ET AL., ASBESTOS LITIGATION COSTS AND COMPENSATION: AN INTERIM REPORT 51 (2002) [hereinafter RAND REPORT] ("[t]hrough the year 2000 over 600,000 claimants had filed against about 6,000 defendants"), available at <http://www.rand.org/publications/DB/DB397/DB397.pdf> (last visited Dec. 22, 2004).

⁵ See *id.* at 41 (stating by mid 1990's, "typical claimant named 60 to 70 defendants"); see also AM. ACAD. OF ACTUARIES, OVERVIEW OF ASBESTOS ISSUES AND TRENDS 3 (2001) (explaining claimants name large number of defendants because most have worked at numerous sites with asbestos-containing products over course of their careers), available at http://www.actuary.org/pdf/casualty/mono_dec01asbestos.pdf (last visited Dec. 22, 2004).

⁶ See Paul F. Rothstein, *What Courts Can Do in the Face of the Never-Ending Asbestos Crisis*, 71 MISS. L.J. 1, 6 (2001) ("the list of defendants has been expanded to include companies with little more than a remote connection to asbestos"); see also AM. ACAD. OF ACTUARIES, *supra* note 5, at 4, 7 (distinguishing "major defendants" as those who produced raw asbestos, installers and insulators from "peripheral defendants" who manufactured products where asbestos was encapsulated, distributors of products containing asbestos, or owners of premises containing asbestos).

⁷ See Francis E. McGovern, *Issues in Civil Procedure: Advancing the Dialogue A Symposium: Resolving Mature Mass Tort Litigation*, 69 B.U. L. REV. 659, 671 (1989) (observing class action approach results in lower transaction costs per plaintiff); RAND REPORT, *supra* note 4, at 25–26, 60 (explaining courts struggle to reduce transaction costs). See generally George M. Cohen, *The "Fair" Is the Enemy of the Good: Ortiz v. Fibreboard Corporation and Class Action Settlements*, 8 SUP. CT. ECON. REV. 23 (2000) (investigating cost savings from class action settlements in asbestos cases).

⁸ See Rothstein, *supra* note 6, at 9–10 (stating all asbestos claims in federal court are consolidated for pre-trial purposes, some state courts place suits involving unimpaired claimants on inactive docket, other state courts consolidate all claims); Michelle J. White, *Why the Asbestos Genie Won't Stay in The Bankruptcy Bottle*, 70 U. CIN. L. REV. 1319, 1336–37 (indicating judges trying new methods to resolve large number of claims quickly, including encouraging defendants to settle large number of suits, consolidating claims and bifurcating trials); cf. AM. ACAD. OF ACTUARIES, *supra* note 5, at 6 (suggesting courts' consolidation of claims involving plaintiffs with markedly different injuries and shortening of discovery period may produce potentially less equitable results).

⁹ See RAND REPORT, *supra* note 4, at 44–46 (noting nonmalignant claims grew in last half of decade); see also *In re* USG Corp., 290 B.R. 223, 225 (Bankr. D. Del. 2003) (discussing debtor's argument of most asbestos personal injury claims being "meritless nonmalignant claims"); AM. ACAD. OF ACTUARIES, *supra* note 5, at 3 (reporting in 2000 vast majority of claims made alleged nonmalignant injuries).

¹⁰ See AM. ACAD. OF ACTUARIES, *supra* note 5, at 3 ("It is estimated that more than 90 percent (or more than 54,000 claims filed during 2000) are for claimants alleging nonmalignant injuries."); see also Findley v. Tr. of the Manville Pers. Injury Settlement Trust (*In re* Joint E. & S. Dist. Asbestos Litig.), 237 F. Supp. 2d 297, 306 (Bankr. S.D.N.Y. 2002) (explaining large number of claims filed by functionally unimpaired plaintiffs is due to "recent acceleration" in asbestos litigation).

¹¹ See *N. Am. Asbestos Corp. v. Superior Court*, 179 Cal. Rptr. 889, 890 (1982); see also Mark D. Plevin & Paul W. Kalish, *Where Are They Now? A History of the Companies that Have Sought Bankruptcy Protection Due to Asbestos Claims*, 1-1 MEALEY'S ASB. BANKR. REP. 21 n.3 (2001) (indicating even though UNR Industries was first asbestos defendant to file for chapter 11, North American Asbestos Corp. filed for dissolution in 1978).

of UNR Industries and Johns-Manville Corporation, commenced in 1982,¹² established a mechanism to protect a company from excessive asbestos liability exposure by channeling personal injury claims to a trust against which future asbestos claimants have their sole recourse.¹³ This "channeling injunction" mechanism was codified in 1994 in section 524(g) of the Bankruptcy Code.¹⁴ The amendment is specific to asbestos bankruptcies, and is a significant departure from typical bankruptcy cases, which compromise claims existing as of the date the bankruptcy petition is filed, but not claims that arise thereafter.¹⁵ In asbestos cases, the creditor body includes not only existing or present claimants, but also a significant number of future claimants: persons who were exposed to asbestos prior to a defendant's bankruptcy filing may not develop asbestos-related injuries until much later. Section 524(g) permits the debtor to protect itself against these "future" claims.

Section 524(g) is therefore significant because it is the mechanism by which an asbestos defendant may shield itself from liability by diverting not only present, but also future or unknown claimants, to a limited fund for payment. The United States Supreme Court has established that class action settlements are not available to bind future claimants. In *Amchem Products, Inc. v. Windsor*,¹⁶ plaintiffs attempted to certify, for settlement purposes, a class comprising everyone with asbestos exposure who had not filed a lawsuit as of the commencement of the class action.¹⁷ The Court held that the requirements of common issue predominance and adequacy of representation under Rule 23 of the Federal Rules of Civil Procedure were not met. The Court did not reach the issue of adequacy of notice.¹⁸ Two years later, in *Ortiz v. Fibreboard Corp.*,¹⁹ the Supreme Court again considered the issue of binding class action settlements in the asbestos context, similarly holding that a mandatory class could not be certified in a limited fund case binding future claimants.²⁰

Because large class action settlements are not available to bind future or unknown claimants who are not included in the class, and as a result of the steadily growing tide of asbestos litigation, the

¹² *In re UNR Indus.*, 71 B.R. 467, 470 (Bankr. N.D. Ill. 1987) (noting petition filed July 29, 1982); *Findley v. Blinken (In re Joint E. & S. Dist. Asbestos Litig.)*, 120 B.R. 648, 651 (E. & S.D.N.Y. 1990) (reporting reorganization petition filed August 26, 1982).

¹³ Property claims may also be channeled to a separate trust. See *In re Johns-Manville Corp.*, 68 B.R. 618, 622 (Bankr. S.D.N.Y. 1986) (indicating property damage trust was founded to resolve Class 5 asbestos related property claims). The focus of this article is on personal injury claims, and the general terms "claim" and "trust" used herein refer to personal injury claims and trusts unless indicated otherwise.

¹⁴ See 11 U.S.C. § 524(g) (2000); see also *In re Mrs. Weinberg's Kosher Foods, Inc.*, 278 B.R. 358, 363–64 (Bankr. S.D.N.Y. 2002) (discussing, in depth, injunction and channeling mechanisms used in Johns-Manville case later codified in section 524(g)); Linda J. Rusch, *Unintended Consequences of Unthinking Tinkering: The 1994 Amendments and the Chapter 11 Process*, 69 AM. BANKR. L.J. 349, 389–90 (1995) (explaining channeling injunction and section 524(g)).

¹⁵ Even notwithstanding 11 U.S.C. § 524(g), a bankruptcy court has broad power under 11 U.S.C. § 105, which allows the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. 11 U.S.C. § 105(a). This provision was the statutory predicate for the channeling injunction in *Johns-Manville*. See *Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.)*, 801 F.2d 60, 64 (2d Cir. 1986).

¹⁶ 521 U.S. 591 (1997).

¹⁷ *Id.* at 597 (explaining plaintiffs' proposition for settlement class consisting of all people who were or may be in future adversely affected by exposure to asbestos).

¹⁸ *Id.* at 628 ("Because we have concluded that the class in this case cannot satisfy the requirements of common issue predominance and adequacy of representation given here, we need not rule, definitively, on the notice given here."); see also Kevin R. Bernier, Note, *The Inadequacy of the Broad Collateral Attack: Stephenson v. Dow Chemical Company and its Effect on Class Action Settlements*, 84 B.U. L. REV. 1023, 1043 (2004) (reiterating *Amchem Products* court did not rule definitively on issue of adequacy of notice); Georgene Vairo, *Mass Torts Bankruptcies: The Who, The Why and The How*, 78 AM. BANKR. L.J. 93, 103 (2004) (stating plaintiff class discussed in *Amchem Prods.* included people who did not know of their prior exposure to asbestos, rendering all forms of notice of bankruptcy case, actual or constructive, meaningless to them).

¹⁹ 527 U.S. 815 (1999).

²⁰ *Id.* at 864 (holding creation of mandatory class containing future and present claimants improper because of internal conflicts); see also Semra Mesulam, Note, *Collective Rewards and Limited Punishment: Solving the Punitive Damages Dilemma with Class*, 104 COLUM. L. REV. 1114, 1148 (2004) (stating court in *Ortiz* overturned certification of mandatory limited fund class because certification of class would deprive future claimants of their seventh amendment right to jury trial). But see *Zomber v. Christies, Inc. (In re Auction Houses Antitrust Litig.)*, 42 Fed. Appx. 511, 520–21 (2d Cir. 2002) (declaring possibility of certifying mandatory class to protect putative plaintiffs' interests as long as party seeking limited fund class shows fund is actually limited).

section 524(g) channeling injunction has attracted even financially stable companies with asbestos-related liabilities to chapter 11 as the only mechanism to settle uncertain but potentially enormous future liability for a determined sum.

Just as asbestos claims have increased in the last several decades and lowered transaction costs allow faster resolutions of claims,²¹ so has the pace of asbestos bankruptcies accelerated. Johns-Manville did not confirm its plan until four years after filing its petition;²² the futures trust agreement was executed, and the plan thereby consummated, nearly two years following confirmation.²³ Since that early case, the process has become streamlined. In order to obtain the benefits of the 524(g) channeling injunction with the minimum disruption on business, asbestos debtors in the past few years increasingly have begun to turn to "pre-packaged" bankruptcies ("pre-packs"). Unlike a traditional or "free-fall" bankruptcy in which a debtor files a petition and proceeds to formulate and negotiate a plan of reorganization, in a pre-pack, the debtor files a bankruptcy petition along with a pre-negotiated, pre-approved plan. This carries the promise of a minimal stay in bankruptcy; the first asbestos pre-pack lasted just over two months from petition to confirmation.²⁴ Since then, there have been at least six other significant asbestos-

²¹ See, e.g., White, *supra* note 8, at 1328–30 (explaining number of claims against asbestos defendants has continued to rise over past decades and fixed transaction costs provide incentive to name more defendants in each plaintiff's suit); *supra* notes 6, 9–10 and accompanying text.

²² See *Hosp. & Univ. Prop. Damage Claimants v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 7 F.3d 32, 33 (2d Cir. 1993) (stating Manville filed voluntary petition for reorganization under chapter 11 on August 26, 1982 and plan was confirmed, four years later, on Dec. 22, 1986); see also JOHNS MANVILLE, JOHNS MANVILLE COMPANY HISTORY, at <http://www.jm.com/corporate/56.htm> (last visited Dec. 26, 2004) (listing 1986 as year when bankruptcy plan was confirmed).

²³ See *Findley v. Blinks* (*In re Joint E. & S. Dist. Asbestos Litig.*), 129 B.R. 710, 751 (E. & S.D.N.Y., Bankr. S.D.N.Y. 1991) (reporting trust agreement became operative Nov. 28, 1988); see also White, *supra* note 8, at 1322 (reiterating fact that Johns-Manville's reorganization plan did not become effective until six years after initial filing of the petition); JOHNS MANVILLE, JOHNS MANVILLE COMPANY HISTORY, available at <http://www.jm.com/corporate/56.htm> (last visited Dec. 26, 2004) (noting trust agreement was executed and company emerged from chapter 11 in 1988).

²⁴ See generally *Voluntary Chapter 11 Petition, In re Fuller-Austin Insulation Co.*, No. 98-02038, 1998 WL 812388, at *1 (Bankr. D. Del. Nov. 10, 1998) (indicating petition was filed on Sept. 4, 1998); *Order Approving the Disclosure Statement and Confirming Plan of Reorganization for Fuller-Austin Insulation Co.*, *In re Fuller-Austin Insulation Co.*, No. 98-02038, 1998 WL 812388, at *1 (Bankr. D. Del. Nov. 10, 1998) (noting approval was granted on Nov. 13, 1998); Kenneth Pasquale, *Combustion Engineering: Can a Pre-packaged Plan Satisfy §524(g)?*, 23 AM. BANKR. INST. J. 1, 42 (June 2004) (discussing recent trend of resolving asbestos liabilities through pre-packaged bankruptcies).

related pre-packs:

Debtor	Petition Date	Date Plan Confirmed
Fuller-Austin Insulation Co.	September 4, 1998	November 13, 1998
Shook and Fletcher Insulation Co.	April 8, 2002	October 29, 2002
J.T. Thorpe Co.	October 1, 2002	January 29, 2003
Combustion Engineering (ABB)	February 17, 2003	August 8, 2003
Halliburton Company	December 16, 2003	Not yet confirmed
Congoleum Corporation	December 31, 2003	Not yet confirmed
Utex Industries, Inc.	March 26, 2004	Not yet confirmed

The rapid pace at which these bankruptcies are conducted, however, has come at a price: compliance with the procedural and substantive requirements of the Bankruptcy Code has been sacrificed in the haste. Furthermore, because negotiations in a pre-pack take place outside of the watchful eye of the bankruptcy court, the problems inherent in asbestos litigation—including conflicts of interest, inadequate representation of asbestos plaintiffs, and the prevalence of nonmalignant claims—can more easily carry over into a pre-packaged than a conventional bankruptcy.²⁵

II. THE GENESIS OF 524(G)

In order to interpret and understand the purpose of section 524(g), it is necessary to examine the case on whose mechanisms it is modeled.²⁶ Section 524(g) establishes procedures that closely and deliberately follow the channeling injunction and trust mechanisms utilized in the Johns–Manville case.²⁷ Indeed, the section was intended not only to provide these mechanisms to other asbestos debtors, but also to give congressional support to the existing Johns–Manville and UNR trusts in order to ease potential investors' fears that they would acquire asbestos liability along with company stock if the injunction were later overturned.²⁸

²⁵ For a more detailed discussion of these issues, see Proposed Findings of Fact and Conclusions of Law Re: Chapter 11 Plan of Confirmation at 9–10, *In re ACandS, Inc.*, 311 B.R. 36, (Bankr. D. Del. 2004) (No. 02-12687) (refusing to confirm plan because it did not satisfy all requirements of section 524(g)); Appeal of Joseph Rice Order, *In re Combustion Eng'g, Inc.*, (D. Del. Sept. 15, 2003) (No. 03-10495) (unpublished opinion, on file with authors) (holding bankruptcy court lacked subject matter jurisdiction and was without equitable authority to order negotiator of pre-packaged bankruptcy plan to take certain actions due to perceived conflict of interest due to fact negotiator was paid \$20 million by parent corporation of debtor he was suing); Mark D. Plevin et al., *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. TEX. L. REV. 883, 907–22 (2003) (arguing pre-packaged asbestos bankruptcies "pervert and distort the purposes of Section 524(g)" because, among other things, plan negotiations take place in secret, similarly situated claimants receive different treatment, future claimants' representative is bound to terms of deal debtor negotiated, and conflicts of interest are common); Editorial, *St. Francis of Asbestos*, WALL ST. J., June 15, 2004, at A14 (discussing creditors' motion in Owens Corning's bankruptcy proceedings which argued Francis McGovern, who was appointed mediator in bankruptcy litigation, had conflicts of interest based on his ties with plaintiffs' bar).

²⁶ Prior to the enactment of section 524(g), the authority to issue channeling injunctions was found in the broad power granted to bankruptcy courts pursuant to 11 U.S.C. § 105(a). The legislative history makes clear that section 524(g) "is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan of reorganization." 140 CONG. REC. H10752-01 (daily ed. Oct. 4, 1994); see Andrew W. Caine & Thomsen Young, *Need Post-Confirmation Injunctive Relief? Get Some Class*, 14 AM. BANKR. INST. J. 30, 31 (Nov. 1995) (noting section 524(g) codified *Manville* for asbestos cases); Pasquale, *supra* note 24, at 42 (stating purpose of section 524(g) was to codify manner in which personal-injury asbestos claims are resolved).

²⁷ See *Findley v. Blinken (In re Joint E. & S. Dist. Asbestos Litig.)*, 982 F.2d 721, 725 (2d Cir. 1992) (describing trust mechanism, which will satisfy claims of present and future claimants); 140 CONG. REC. H10752, H10765 (daily ed. Oct. 4, 1994) ("The procedure is modeled on the trust injunction in the Johns-Manville case, which pioneered the approach a decade ago in response to the flood of asbestos lawsuits it was facing.")

²⁸ See 140 CONG. REC. H10765 (daily ed. Oct. 4, 1994) (stating "lingering uncertainty in the financial community as to whether the injunction can withstand all challenges has apparently made it more difficult for [Johns–Manville] to meet its needs for capital and has depressed the value of its stock" and additionally stating "[t]he asbestos trust injunction . . . is written . . . so that Johns-Manville and UNR, both of which have met and surpassed the standards imposed in this section, will be able to take advantage of the certainty it

Johns–Manville was the largest asbestos supplier and the largest manufacturer of asbestos-containing products in the United States from the 1920's until the 1970's.²⁹ In fact, Johns–Manville "boasted in an article in Asbestos Magazine in 1970 that 'Johns–Manville participates in almost every facet of the Asbestos Industry and is the largest supplier of asbestos in the United States.'"³⁰ Its industry dominance came back to haunt Johns–Manville when asbestos lawsuits began mounting in the late 1970's to 1980's.³¹ Estimated future liability of between \$1 and \$2 billion³² drove Johns–Manville to commence, on August 26, 1982, what was then considered "one of the most complicated and difficult bankruptcy reorganizations in history."³³

Future liability for unknown claims was a (perhaps *the*) chief concern in *Johns–Manville*.³⁴ To address this problem, Johns–Manville's reorganization plan, confirmed on December 22, 1986,³⁵ provided for the creation of a trust as the exclusive entity from which present and future asbestos personal injury claimants could seek compensation.³⁶ The plan contemplated, based on estimates of future liability, that the trust would pay claims in full.³⁷ The trust was funded with \$1.059 billion in cash (\$909 million of this comprised proceeds from insurance settlements in exchange for broad protections from the insurers), two

provides without having to reopen their cases"); see also Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non–Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 1009–10 n.176 (1997) (explaining announced purpose of section 524(g) injunctions was to permit asbestos products manufacturers to reorganize); Leslie Shmaruk, *Establishing a Simple Framework; Classification & Treatment of Claims in Asbestos Reorganizations*, 15 BANKR. STRATEGIST 5, 5 (Feb. 1998) (noting section 524(g) makes it clear future asbestos claims are discharged against debtor and reorganized entity).

²⁹ See *In re Joint E. & S. Dist. Asbestos Litig.*, 982 F.2d at 725 (explaining Johns–Manville Corp. was world's largest manufacturer of asbestos); see also *Sealover v. Carey Canada*, 996 F.2d 42, 44 (3d Cir.1993) (noting Johns–Manville was "nation's leading producer of asbestos-containing products"); *Falise v. Am. Tobacco Co.*, 94 F. Supp. 2d 316, 323 (E.D.N.Y. 2000) (claiming Johns–Manville was "largest manufacturer of asbestos-containing products").

³⁰ *Falise*, 94 F. Supp. 2d at 323; see *In re Johns–Manville Corp.*, No. 82 B 11656, 2004 WL 1876046, at *2 (Bankr. S.D.N.Y. Aug. 17, 2004) (indicating that according to most sources, Johns–Manville was largest asbestos producer in U.S.); *Findley v. Blinken (In re Joint E. & S. Dist. Asbestos Litig.)*, 129 B.R. 710, 742 (E. & S.D.N.Y., Bankr. S.D.N.Y. 1991) (discussing Johns–Manville's asbestos industry prominence).

³¹ See *Falise*, 94 F. Supp. 2d at 325 (explaining history of asbestos lawsuits beginning in late 1970's); Richard O. Foulke, *Dispelling the Myths of Asbestos Litigation: Solutions for Common Law Courts*, 44 S. TEX. L. REV. 945, 947 (2003) (discussing emergence of asbestos litigation in 1970's); Sandra Freidman, Note, *Manville: Good Faith Reorganization or "Insulated" Bankruptcy*, 12 HOFSTRA L. REV. 121, 121 (1983) (remarking on onslaught of claims in 1980's).

³² See *Findley v. Blinken (In re Joint E. & S. Dist. Asbestos Litig.)*, 120 B.R. 648, 651 (E. & S.D.N.Y. 1990) (projecting liability at "more than one billion dollars"); *Kane v. Johns–Manville Corp. (In re Johns–Manville Corp.)*, 843 F.2d 636, 639 (2d Cir. 1988) (estimating liability of "approximately \$2 billion"); Judith Camille Glasscock, *Emptying the Deep Pocket in Mass Tort Litigation*, 18 ST. MARY'S L.J. 977, 993 n.75 (1986) (projecting future liability at two billion dollars).

³³ *Manville Corp. v. Equity Sec. Holders Comm. (In re Johns–Manville Corp.)*, 801 F.2d 60, 69 (2d Cir. 1986) (Oakes, J., dissenting); see Michael A. Hiltzik, *Manville Plan Leaves Open Question of Firm's Survival*, L.A. TIMES, Jan. 4, 1987, at 4 (acknowledging Manville was one of most difficult reorganizations in history).

³⁴ See *In re Johns–Manville Corp.*, 843 F.2d at 639 (noting from outset of reorganization all individuals involved recognized importance of future liability); Jeffrey Davis, *Cramming Down Future Claims in Bankruptcy: Fairness, Bankruptcy Policy, Due Process, and the Lessons of the Piper Reorganization*, 70 AM. BANKR. L.J. 329, 336 (1996) (discussing potentially crushing nature of Johns–Manville's future liability); cf. Alan N. Resnick, *Bankruptcy As a Vehicle for Resolving Enterprise Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2073 (1999) (stating purpose of "asbestos amendments" was to protect debtor manufacturers from future liability).

³⁵ *In re Johns–Manville Corp.*, 68 B.R. 618, 621 (Bankr. S.D.N.Y. 1986) (announcing plan was overwhelmingly accepted and ordering debtor, on Dec. 18, 1986, to submit order of confirmation pursuant to plan); see *In re Joint E. & S. Dist. Asbestos Litig.*, 120 B.R. at 651 (stating confirmation occurred on Dec. 22, 1986).

³⁶ See *In re Joint E. & S. Dist. Asbestos Litig.*, 120 B.R. at 652 (explaining trust became exclusive source of compensation for existing and future claimants); see also *Findley v. Blinken (In re Joint E. & S. Dist. Asbestos Litig.)*, 129 B.R. 710, 752 (E. & S.D.N.Y., Bankr. S.D.N.Y. 1991) ("The Plan provided for the creation of the Trust which was designed to satisfy fully Manville's asbestos-related liability.").

³⁷ See *Falise v. Am. Tobacco Co.*, 94 F. Supp. 2d 316, 325 (E.D.N.Y. 2000) (remarking Manville reorganization plan called for full payment to all claimants based on original estimate of number of claims to be made); Frank J. Macchiarola, *The Manville Personal Injury Settlement Trust: Lessons for the Future*, 17 CARDOZO L. REV. 583, 583 (1996) (reporting it was originally thought Manville had sufficient assets to pay all claimants); Steven L. Schultz, *In re Joint Eastern and Southern District Litigation: Bankrupt and Backlogged—A Proposal for the Use of Federal Common Law in Mass Tort Class Actions*, 58 BROOK. L. REV. 553, 566 (1992) ("The parties hoped that by channeling all of the asbestos claims to the trusts and protecting the reorganized debtor, the trusts would be assured of a continued source of financial support for as long as needed.").

bonds with an aggregate value of \$1.8 billion, and eighty percent of the equity securities of the reorganized Manville (24 million shares of common stock and 7.2 million shares of convertible preferred stock).³⁸ The trust also received accounts receivable and, importantly, up to twenty percent of the profits of the reorganized Manville for as long as needed to pay claims.³⁹ Because the plan permitted the trust to call on those profits, at the time the plan was approved the viability of the reorganized Manville was a key concern—considered more important than the valuation and comparison of trust assets and future liability.⁴⁰ However, due to the unforeseen volume of claims filed (150,000 claims had been filed by March 30, 1990, whereas the plan estimated between 83,000 and 100,000 claims over the life of the trust),⁴¹ the trust became insolvent within two years.⁴²

Even after the trust became insolvent, requiring modification of the trust agreement, lawmakers praised the Johns–Manville trust system. Congress called the plan "a creative solution to help protect the future asbestos claimants."⁴³ One *Johns–Manville* decision noted, "[t]he Plan undertook to resolve a complex reorganization in a novel and creative fashion. Such efforts should be encouraged under the flexibility of the bankruptcy laws without excessively hindering the reorganized entities from responding to substantially changed circumstances."⁴⁴ Judge Feinberg of the Second Circuit Court of Appeals deemed the Manville plan a "first-rate achievement in a very difficult situation."⁴⁵

Although the initial *Manville* trust failed to pay 100% of the scheduled value of claims as originally contemplated and had to be modified,⁴⁶ its mechanism was codified in section 524(g) of the Bankruptcy Code. Congress undoubtedly saw the trust and channeling injunction not as a way for a culpable actor⁴⁷ to escape liability, but as the only means to protect future claimants given a limited pool of assets and the best way to resolve a seemingly hopeless situation. The legislative history of section 524(g) suggests that Congress contemplated a situation in which the only choice was between reorganization (centered around the section 524(g) trust) and liquidation, which would have left future claimants with no remedy at all as

³⁸ *In re Joint E. & S. Dist. Asbestos Litig.*, 120 B.R. at 652.

³⁹ *See id.* ("[t]he Trust is entitled to twenty percent of Manville's profits for as long as necessary to satisfy all asbestos health claims.").

⁴⁰ The court in *In re Johns-Manville Corp.* stated:

[F]unding of the Trust will continue until the last asbestos victim is found and paid. Thus an effort to determine the number and amount of A[sbestos] H[ealth] claims with exactitude is not imperative. The imperative rather, is to ensure to the greatest degree possible the continuing viability of the reorganized corporation, which will fund the Trust, whatever the number and amount of claims happen to be.

68 B.R. at 622. *But see* Laurens Walker, *A Model Plan to Resolve Federal Class Action Cases by Jury Trial*, 88 VA. L. REV. 405, 423 (2002) (suggesting perhaps more emphasis should have been put on estimating accurate of number of future claimants).

⁴¹ *In re Joint E. & S. Dist. Asbestos Litig.*, 120 B.R. at 652; *see* Jones v. Keene Corp., 933 F.2d 209, 211 (3d Cir. 1991) ("The assumptions on which the Fund was created have proven wrong. It has failed its purpose and its recent performance is particularly alarming."); Macchiarola, *supra* note 37, at 603 (indicating by Mar. of 1990, trust was facing fifty percent more claims than trust was designed to accommodate over its entire existence).

⁴² *See* Findley v. Blinken (*In re Joint E. & S. Dist. Asbestos Litig.*), 982 F.2d 721, 727 (2d Cir. 1992) (stating trust was out of money by spring of 1990); *see also* Schultz, *supra* note 37, at 555 (noting trust was "deeply insolvent"); Walker, *supra* note 40, at 423 (explaining trust was depleted as of 1990).

⁴³ 140 CONG. REC. H10752 (daily ed. Oct. 4, 1994); *see* Schultz, *supra* note 37, at 624 ("[t]he court's decision [in *Manville*] did represent an important initial step in asbestos litigation"); J. Maxwell Tucker, *The Clash of Successor Liability Principles, Reorganization Law, and the Just Demand that Relief by Afforded Unknown and Unknowable Claimants*, 12 BANKR. DEV. J. 1, 52 n.285 (1995) (asserting Johns-Manville trust pioneered approach of establishing trust to pay future claimants).

⁴⁴ Findley v. Blinken (*In re Joint E. & S. Dist. Asbestos Litig.*), 129 B.R. 710, 841 (E. & S.D.N.Y., Bankr. S.D.N.Y. 1991).

⁴⁵ *In re Joint E. & S. Dist. Asbestos Litig.*, 982 F.2d at 752 (Feinberg, J., dissenting).

⁴⁶ *See* Resnick, *supra* note 34, at 2081 (explaining trust "fell short of preserving assets" needed to compensate future claimants); *Judge Approves Plan to Aid Manville Trust*, N.Y. TIMES, Dec. 16, 1994, at D5 (noting *Manville* trust was being modified); MANVILLE PERSONAL INJURY SETTLEMENT TRUST, A HISTORY OF THE TRUST, at <http://www.mantrust.org/history.htm> (last modified Aug. 2, 2004) (arguing trust was inundated with unexpected litigation which lead to its demise and subsequent modification).

⁴⁷ Johns-Manville was aware of, and was attempting to cover up, the health hazards of asbestos as early as 1932. *See* Falise v. Am. Tobacco Co., 94 F. Supp. 2d 316, 324–25 (E.D.N.Y. 2000) (describing Johns–Manville cover up of health hazards associated with asbestos); *In re Joint E. & S. Dist. Asbestos Litig.*, 129 B.R. at 744 (describing Manville's censoring of studies and publications as they would have brought hazards of asbestos to light).

there would be no company to proceed against and no assets from which claimants could be paid.⁴⁸ The channeling injunction and trust mechanism, while a failure in practice, remained an innovative and desirable solution in theory. It was out of these ashes that section 524(g) was born.

Section 524(g) was based on *Johns-Manville*, but it has been applied to asbestos bankruptcies bearing little resemblance to that case. At the same time, the procedures section 524(g) establishes—and those of bankruptcy law generally—have been expanded as asbestos bankruptcy has become more widespread. The following discussion attempts to illustrate the various ways in which asbestos bankruptcies and, in particular, the latest wave of pre-packs have side-stepped the strict requirements of the Bankruptcy Code, to the detriment of parties not represented in the pre-bankruptcy process.

III. NON-COMPLIANCE WITH THE CODE'S SUBSTANTIVE REQUIREMENTS

A. Good Faith

A chapter 11 debtor must act in good faith in filing both the bankruptcy petition and the plan. A chapter 11 case may be dismissed "for cause" pursuant to 11 U.S.C. § 1112(b). "Although section 1112(b) does not explicitly require that cases be filed in 'good faith,' courts have overwhelmingly held that a lack of good faith in filing a chapter 11 petition establishes cause for dismissal."⁴⁹ Furthermore, the Bankruptcy Code imposes an explicit precondition to confirmation that a plan "has been proposed in good faith and not by any means forbidden by law."⁵⁰ Because a debtor may not obtain a section 524(g) injunction except in conjunction with a confirmed plan of reorganization,⁵¹ that good faith finding is an essential prerequisite to the relief asbestos companies seek.

It is that second good faith requirement, the statutory prerequisite to plan confirmation, that provided a basis for Judge Newsome's recommendation against plan confirmation in *ACandS*.⁵² In finding that the *ACandS* plan should not be confirmed because it was not filed in good faith as required by section 1129(a)(3), Judge Newsome noted potential bias and conflicts in the retention of the "independent claims reviewer" who had been retained to review claims documentation.⁵³ He also noted that the plan appeared to have been largely drafted by the pre-petition asbestos creditors' committee, and that key negotiations were catered to that committee.⁵⁴

The Bankruptcy Code also implicitly requires that the petition itself be filed in good faith. Whether recent pre-packaged petitions, some of which appear to have been filed by healthy companies for the sole purpose of escaping asbestos litigation and consequent depression of stock prices, satisfy this requirement

⁴⁸ The Congressional Record, discussing section 524(g), states:

The Committee remains concerned that full consideration be accorded to the interests of future claimants who, by definition, do not have their own voice. Nevertheless, the Committee also recognizes that the interests of future claimants are ill-served if Johns-Manville and other asbestos companies are forced into liquidation and lose their ability to generate stock value and profits that can be used to satisfy claims.

140 CONG. REC. H10765 (daily ed. Oct. 4, 1994); see Francis E. McGovern, *Asbestos Legislation II: Section 524(g) Without Bankruptcy*, 31 PEPP. L. REV. 233, 252–53 (2003–04) (stating purpose of legislation is to provide sufficient assets to fully compensate future asbestos claimants). See generally 11 U.S.C. § 524(g)(2)(B)(ii)(V) (2000) (affirming legislation intended to treat future claimants in substantially same manner as present claimants).

⁴⁹ *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994) (citations omitted); see also *Stolrow v. Stolrow's, Inc. (In re Stolrow's, Inc.)*, 84 B.R. 167, 170 (B.A.P. 9th Cir. 1988) (agreeing it is appropriate to dismiss chapter 11 case if it appears petition was filed in bad faith); *Little Creek Dev. v. Commonwealth Mortgage (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1071 (5th Cir. 1986) (stating every bankruptcy statute since 1898 has implied standard of good faith).

⁵⁰ 11 U.S.C. § 1129(a)(3) (2000); see cases cited *supra* note 52.

⁵¹ See 11 § 524(g)(1)(A).

⁵² See *In re ACandS, Inc.*, 311 B.R. 36, 42–43 (Bankr. D. Del. 2004).

⁵³ *Id.* at 40, 43.

⁵⁴ *Id.* at 43.

is questionable. For example, in *In re SGL Carbon Corp.*,⁵⁵ the Third Circuit ordered a chapter 11 petition to be dismissed where the motivation for filing was to escape pending civil antitrust actions.⁵⁶ Central to the court's decision was the fact that the company was financially healthy; in fact, its management had repeatedly stated that the company was healthy and had filed the bankruptcy petition because the antitrust claims were causing the company to lose market share.⁵⁷ Noting that the Bankruptcy Code does not require that the debtor demonstrate its insolvency in order to sustain a chapter 11 filing, the court continued, "SGL Carbon cites no case holding that petitions filed by financially healthy companies cannot be subject to dismissal for cause."⁵⁸ The court distinguished *Johns-Manville*, among other cases, on the basis that although Johns-Manville filed because of the threat of pending litigation, Johns-Manville faced substantial financial difficulties: "A growing wave of asbestos-related claims forced the debtor to either book a \$1.9 billion reserve thereby triggering potential default on a \$450 million debt that, in turn, could have forced partial liquidation, or file a Chapter 11 petition."⁵⁹ As described above, this very dilemma underlay Congress's decision to codify the channeling injunction in section 524(g).

Halliburton Company, whose affiliates filed pre-packaged plans on December 16, 2003, faces no such dilemma. On the contrary, Halliburton's circumstances fit neatly within the facts of *SGL Carbon*. In affidavits filed on the first day of the bankruptcy case, Halliburton's management acknowledged that the company was solvent and capable of paying asbestos claims in perpetuity. As Halliburton's Executive Vice President and General Counsel put it, "the Debtors are filing the Plan to avail themselves of the protections available under sections 105 and 524(g) of the Bankruptcy Code and not due to any financial difficulties."⁶⁰ But the good faith issue has yet to be tested: On the first day of the case, certain of Halliburton's insurers moved for dismissal of the bankruptcy case on the basis that it was filed in bad faith.⁶¹ The insurers' motion to dismiss was denied on the grounds that the insurers are not creditors and the plan did not adjudicate their liability. On these bases, Judge Fitzgerald held that the insurers lacked standing to object to the bankruptcy filing: "I find that the certain insurers' interests are not affected by the filing of this case, either directly or indirectly. They are not a 'person aggrieved' as their pecuniary interests are not directly, indirectly or adversely affected."⁶² No other party has challenged the filing, which suggests a reason that the insurers should have a voice in the proceedings. As long as there are

⁵⁵ Official Comm. of Unsecured Creditors v. Nucor Corp. (*In re SGL Carbon Corp.*), 200 F.3d 154 (3d Cir. 1999).

⁵⁶ *Id.* at 169–70.

⁵⁷ *Id.* at 157–58, 163; cf. *In re SGL Carbon Corp.*, 233 B.R. 285, 287 (Bankr. D. Del. 1999) (noting filing of bankruptcy petition is tactic used to frustrate prosecution of civil antitrust claims while preserving equity from these claims). *But see In re Bible Speaks*, 65 B.R. 415, 424 (Bankr. D. Mass. 1986) (noting, under section 109 and section 301, debtors need not be insolvent before filing for bankruptcy).

⁵⁸ *In re SGL Carbon Corp.*, 200 F.3d at 164.

⁵⁹ *Id.*

⁶⁰ Aff. of Albert O. Cornelison in Supp. of Debtors' Chapter 11 Pet. and First Day Mot. and Applications ¶ 30 at 10, *In re Mid-Valley, Inc.*, 305 B.R. 425 (Bankr. W.D. Pa. 2003) (No. 03-35592). Additionally, the CFO of another debtor involved in these reorganization cases stated:

This is not a typical chapter 11 case and does not involve debtors in financial distress . . . The Debtors are solvent entities and are seeking to utilize the unique provisions of the Bankruptcy Code not only to resolve their present and future asbestos and silica-related personal injury liability but also to preserve and enhance their financial viability and worth.

Aff. of Bruce A. Stanski in Supp. of Debtors' Chapter 11 Pet. and First Day Mot. and Applications and in Supp. of the Confirmation of the Debtors' Plan of Reorganization ¶¶ 4–5 at 3, *In re Mid-Valley, Inc.*, 305 B.R. 425 (Bankr. W.D. Pa. 2003) (No. 03-35592); see *In re SGL Carbon Corp.*, 200 F.3d at 164 (finding ability of debtor to meet its debts is only one factor used in determining whether debtor entered chapter 11 with valid reorganizational purpose).

⁶¹ See Mot. of Hartford Accident and Indemnity Company and Certain of its Affiliates to Dismiss these Bankruptcy Cases as Bad Faith Filings, *In re Mid-Valley, Inc.*, 305 B.R. 425 (Bankr. W.D. Pa. 2003) (No. 03-35592) (arguing these chapter 11 cases are bad faith filings because debtors have no need to reorganize, proposed plan is inconsistent with purposes of Bankruptcy Code and violates requirements of section 524(g), and plan's proposed channeling injunction requiring future claimants to look only to artificially limited trust fund for payment of their claims would raise "serious" constitutional problems).

⁶² Mem. of Oral Op. Read Into the R. at 16, *In re Mid-Valley, Inc.*, 305 B.R. 425 (Bankr. W.D. Pa. 2004) (No. 03-35592).

insurance proceeds in sufficiently large amounts, the other parties are not truly adverse to one another: present claimants, future claimants and defendants are negotiating the distribution of someone else's money. As long as the insurers are denied standing, no one in the proceedings has an interest in seeing that the amount contributed to the trust corresponds to the company's future liability rather than to the amount of insurance proceeds available for payment of claims. Indeed, as the insurers noted in *Congoleum*, another pre-packaged asbestos bankruptcy case, "[t]he appeal of Section 524(g)'s injunction mechanism makes it peculiarly subject to such misuses, particularly in pre-packaged cases where all creditors other than asbestos claimants are treated as 'unimpaired,' thus eliminating all potential dissenters."⁶³

Furthermore, due process issues arise when a channeling injunction binds unknown claimants who had no notice of the injunction and no opportunity to opt out of such treatment. The legislative history to section 524(g) indicates that this was a concern in enacting that amendment to the Bankruptcy Code, but was mitigated on the facts of *Johns-Manville*.⁶⁴ *Johns-Manville* faced enormous asbestos liability in relation to its assets; without the protection of the channeling injunction, the company would face liquidation, to the detriment of future claimants. The trust, on the other hand, provided some remedy to future claimants (although it later proved to be grossly under funded). But there is no such justification for channeling future claims to a limited trust when a company can afford to pay 100 cents on the dollar to all future claimants as their claims arise. Exchanging the right to pursue all of a company's assets (and the right to take ownership of the company, since creditor claims have absolute priority over equity interests) for the right to pursue a thinly-capitalized trust could be detrimental to future claimants if the trust assets later prove to be insufficient. It is one thing if the future claimants agree to make this risky exchange, but by definition they cannot speak for themselves in the bankruptcy case. It may make some sense to permit this exchange if the interests of future claimants are represented by an independent future claims representative (or "FCR"), but where the FCR is selected and compensated by his adversaries, the bargain agreed to is questionable. Given this critical divergence from the facts of *Johns-Manville* on which section 524(g) was based, that statute should be narrowly construed to apply only to situations where a company demonstrates that it cannot continue to pay asbestos-related claims. Indeed, the fact that the channeling injunction is available only in the context of a chapter 11 bankruptcy plan signifies that this relief should be limited to companies with a legitimate need for bankruptcy protection and reorganization. Otherwise, the good faith of the debtor must be seriously questioned.

IV. DISCRIMINATION

Chief among the protections afforded creditors of a chapter 11 debtor is that similarly situated creditors receive similar treatment. The plan may not group together differently situated creditors in the same class for voting purposes (although the Code does not, on its face, prohibit separate classification of similar claims);⁶⁵ a plan also may not be confirmed over the rejection of an impaired class of creditors if it

⁶³ Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 5 n.4, *In re Congoleum Corp.*, 2004 WL 2339762 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524).

⁶⁴ See *In re Johns-Manville Corp.*, 68 B.R. 618, 626 (Bankr. S.D.N.Y. 1986) (finding national publicity campaign designed to inform future asbestos claimants of impact of reorganization met constitutional standards of notice mandated by due process); *supra* note 18 and accompanying text.

⁶⁵ See 11 U.S.C. § 1122 (2000) (discussing classification of claims or interests); Peter Meltzer, *Disenfranchising The Dissenting Creditor Through Artificial Classification or Artificial Impairment*, 66 AM. BANKR. L.J. 281, 289-90 (1992) (pointing out some courts interpret section 1122 as requiring similarly situated claims be classified together); Howard M. Neuger, *The Authority of a Debtor to Place Substantially Similar Claims into Separate Classes in Order to Cram Down a Reorganization Plan: Should a Bright Line Rule Requiring All Substantially Similar Claims to Be Placed into a Single Class Be Adopted?*, 9 BANKR. DEV. J. 567, 585-86 (1992) (explaining "most sensible interpretation" of section 1122 requires similar claims be placed in same class).

discriminates unfairly against that class.⁶⁶ With respect to asbestos bankruptcies, section 524(g) of the Bankruptcy Code provides additional protection against discrimination: The trust established in connection with the channeling injunction must operate through mechanisms "that provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner."⁶⁷

Judge Newsome's opinion in *ACandS* recommended that confirmation be denied on the basis that the plan discriminated unfairly in contravention of section 524(g). Certainly, it is impossible to predict and value future claims accurately,⁶⁸ and some creditors will inevitably (and unintentionally) be preferred. However, the *ACandS* plan did not merely treat creditors differently due to imperfect valuations. Prior to filing its bankruptcy petition, *ACandS* settled a number of asbestos claims, which would be paid from insurance proceeds.⁶⁹ *ACandS* also established a pre-petition trust to grant those claimants who settled security interests in those insurance proceeds.⁷⁰ The pre-petition trust agreements set forth the agreement that had been reached by the pre-petition committee: asbestos claimants were divided into five classes, to be paid in order of priority.⁷¹ Some of the claimants were paid (in part or in full) pre-petition, while others were not; also, some of the claimants were fully secured, while others received security interests to the extent of 75% of their claims (up to 50% of the insurance proceeds recovered; the remaining half was reserved for future claimants).⁷² Anyone who was not part of this pre-petition agreement (and, to the extent of their unsecured claim, those who fell under the agreement but were only partially secured) would be treated as an unsecured claimant in the bankruptcy and, as Judge Newsome pointed out, unlikely to receive any distribution in the case.⁷³

Judge Newsome noted that there was no apparent basis for granting security interests to some claimants and not to others:

Even though each category has different rights and priorities, all of the categories contain exactly the same sorts of claims. Thus, a claimant in Category A who has some evidence of asbestos exposure but who is not sick would have been paid in full pre[-]petition, while someone with mesothelioma, who was not included (for whatever reason) in Categories A through D, in all probability will never

⁶⁶ See 11 U.S.C. § 1129(b) ("[T]he court . . . shall confirm the plan . . . if the plan does not discriminate unfairly."); see also Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227, 247 (1998) (stating right to assert unfair discrimination belongs to class, not to any individual within a class). But see Davis, *supra* note 34, at 381 (explaining requirement plan not unfairly discriminate has been used infrequently in past to invalidate proposed plans and adds little to other requirements of plan being proposed in good faith, feasible, and properly classified).

⁶⁷ 11 U.S.C. § 524(g)(2)(B)(ii)(V).

⁶⁸ The Code recognizes this difficulty; in fact, it provides that a channeling injunction will not be issued unless "the actual amounts, numbers, and timing of . . . future demands cannot be determined." 11 U.S.C. § 524(g)(2)(B)(ii)(II); see Alisa H. Aczel, Comment, *The Solvency of Mass Tort Defendants: A "Reasonable" Approach to Valuing Future Claims*, 20 BANKR. DEV. J. 531, 542-43 (2004) (recognizing difficulty in predicting amount of future liabilities and number of future claimants); Elihu Inselbuch, *Some Key Issues in Asbestos Bankruptcies*, 44 S. TEX. L. REV. 1037, 1041-42 (2003) (noting inevitability of incorrect estimates of future claims, which tend to be too low).

⁶⁹ See Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code Relating to *ACandS's* Plan of Reorganization Dated Oct. 3, 2003 at 29, *In re ACandS, Inc.*, 311 B.R. 36 (Bankr. D. Del. 2003) (No. 02-12687) ("*ACandS* decided to attempt to settle trial-listed and other asbestos-related bodily injury claims at fair value in consideration for an assignment to settled asbestos claimants of interests in and proceeds from specified insurance policy limits."); see also *In re ACandS, Inc.*, 311 B.R. 36, 39 (Bankr. D. Del. 2003) (discussing *ACandS's* continuous choice to settle claims rather than file chapter 11 petition).

⁷⁰ See Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code Relating to *ACandS's* Plan of Reorganization Dated Oct. 3, 2003 at 29, *In re ACandS, Inc.*, 311 B.R. 36 (Bankr. D. Del. 2003) (No. 02-12687).

⁷¹ *In re ACandS, Inc.*, 311 B.R. at 39 ("The trust memorializes the prepetition committee's agreement that there would be five categories of secured asbestos claimants, to be paid in descending order of priority.").

⁷² See *id.* at 39-40 (discussing settlement payments each category of claimants were to receive under pre-petition agreement).

⁷³ *Id.* at 40 ("Anyone who did not fall into one of these five categories would be treated as an unsecured claimant."). "Unless the trust realizes a resounding victory in its coverage dispute with Travelers it is unlikely that claimants in the unsecured category will receive anything." *Id.*

receive anything.⁷⁴

Judge Newsome found that the requirement that "the trust . . . value, and be able to pay, similar present and future claims in substantially the same manner,"⁷⁵ was not met and denied confirmation of the plan.

Judge Newsome based his denial on an alternate ground: the plan was not "fundamentally fair" and therefore was not proposed in good faith, a prerequisite to confirmation.⁷⁶ Judge Newsome articulated:

Not only does the plan discriminate between present and future claims, it pays similar claims in a totally disparate manner by giving preferential treatment to certain claimants who are secured by insurance proceeds. Those security interests were not granted based upon the medical condition of those claimants, but rather because, for whatever reason, they were first in line and able to carve out seemingly unassailable security interests.⁷⁷

Although secured creditors do receive special consideration under the Bankruptcy Code,⁷⁸ the underlying security interests were granted in such a way as to discriminate even among claimants with similar symptoms or history of exposure. Again, Judge Newsome noted that this was not "fundamentally fair":

Although the plan may meet the technical classification requirements of section 1122 and section 1129(b), it is fundamentally unfair that one claimant with non-symptomatic pleural plaques will be paid in full, while someone with mesothelioma runs the substantial risk of receiving nothing. Both should be compensated based on the nature of their injuries, not based on the influence and cunning of their lawyers.⁷⁹

Section 1122(a) of the Bankruptcy Code requires that a plan classify claims together only if they are "substantially similar."⁸⁰ Proper classification of claims is a vital element of the Bankruptcy Code. "If the Bankruptcy Code did not require separate classification of dissimilar claims, a majority of claim holders might vote to deprive the minority of their rights in violation of the absolute priority rule."⁸¹ In *Congoleum*, the plan grouped together the following disparate interests in the class of "Unsecured Asbestos Personal Injury Claims": current asbestos claimants who did not settle pre-petition; current claimants who settled pre-petition but whose claims were only partially secured (leaving them with

⁷⁴ *Id.*

⁷⁵ *Id.* at 42.

⁷⁶ See 11 U.S.C. § 1129(a)(3) (2000) (codifying good faith requirement in confirmation plan); see also *supra* note 52 and accompanying text (discussing good faith requirement in debtor's filing of petition).

⁷⁷ *In re ACandS, Inc.*, 311 B.R. at 42.

⁷⁸ See, e.g., 11 U.S.C. § 1122 (2000) (providing secured creditors with special considerations which are not granted to unsecured creditors); 11 U.S.C. § 1129(b) (guaranteeing unconsenting secured creditor cash payment equal to at least amount of its lien).

⁷⁹ *In re ACandS, Inc.*, 311 B.R. at 43; see also 11 U.S.C. §§ 1122, 1129(b) (listing basic requirements of classification of claims or interest and forbids unfair discrimination against unconsenting classes); Douglas McLeod, *Judge Rejects Reorganization, Citing Unfair Asbestos Deal*, BUS. INS., Feb. 2, 2004, at 3 (reporting lawyer for ACandS's principal liability insurer, who was also only party to object to debtor's plan, also believed plan discriminated against claimants and lawyers who were not part of pre-petition negotiations).

⁸⁰ See 11 U.S.C. § 1122(a) ("[A] plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class"); see also Alec P. Ostrow, *The "Animal Farm" of Administrative Insolvency*, 11 AM. BANKR. INST. L. REV. 339, 341 (2003) (reiterating requirements of placing substantially similar claims in same class in reorganization plan under chapter 11). But see Bruce A. Markell, *Slouching Toward Fairness: A Reply to the ABCNY's Proposal on Unfair Discrimination*, 58 BUS. LAW. 109, 112 (2002) (arguing creditors that share same pre-bankruptcy priorities or expectations do not necessarily need to be classified together in same class).

⁸¹ Barbara J. Houser et al., *Classification of Claims*, SH054 ALI-ABA 281, 288 (2003); see also Barbara J. Houser, *Classification and Treatment of Foreign Claims in U.S. Bankruptcy Proceedings*, 36 TEX. INT'L. L.J. 475, 477 (2001) (stating same); Paul B. Lewis, *Trouble Down Under: Some Thoughts on the Australian-American Corporate Bankruptcy Divide*, 2001 UTAH L. REV. 189, 220-21 (2001) (stating Bankruptcy Code expressly forbids class "gerrymandering," which occurs when conflicting claims are put in same class and majority imposes its will on minority class).

twenty-five percent unsecured "stub" claims⁸²); and future claimants.⁸³ Such a classification scheme clearly contravenes section 1122(a). Where current and future claimants are competing for payment from a fixed fund, their interests are directly adverse to one another, as every dollar paid to current claimants is a dollar less to be reserved for future claimants.⁸⁴ Moreover, claimants who have been paid seventy-five percent of their claims are not similar to claimants who had no such pre-petition settlements. Some of these creditors are tort claimants, while others—those who have signed settlement agreements, thereby exchanging their contingent liability claim for a non-contingent right to recover a fixed sum—are contract claimants. Although tort and contract claimants may all be unsecured creditors, their interests and incentives in a case such as *Congoleum* are likely to be very different. The contract creditors have an interest in voting to approve a plan that pays their secured claims regardless of what happens to unsecured creditors, while the tort creditors want to recover the highest value possible on their unliquidated claims.

There are other forms of discrimination present in asbestos pre-packs. A more latent discrimination problem, not addressed in *ACandS*, is that current claimants may settle their claims without having to prove their injuries or show that their asbestos exposure was to the defendant's products, while future claimants seeking recourse against the trust may be required to do so.⁸⁵ The Code permits this—a proof of claim is prima facie valid, and the claim will be allowed unless a party-in-interest objects⁸⁶—but where parties to a bankruptcy case are truly adverse to one another, claims are typically scrutinized and objections made to improper claims. Because of the endemic conflicts in asbestos litigation, this inquiry is largely absent even when it is most needed (since the rights of future claimants are at stake). In fact, there is an incentive to impose lax standards on present claimants, as providing them that advantage helps secure their agreement to the plan, which is required to meet the seventy-five percent supermajority approval requirement imposed by section 524(g). Furthermore, plaintiffs' attorneys typically settle large blocks of claims together, resulting in greater recovery for exposure-only claimants at the expense of

⁸² See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 17, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524) ("The claims of all other existing asbestos claimants who elected to participate in the settlement were to be partially secured by rights to insurance in an amount equal to 75% of the value established by a 'Compensable Disease Matrix' . . . with the remaining 25% of the matrix value being treated as an unsecured claim in Congoleum's bankruptcy case"). See generally Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47, 55–56 (1997) (discussing issues concerning conflicting interests of specialized creditors).

⁸³ See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 24, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524). See generally *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 622–28 (1997) (holding interests of present and future claimants injured by asbestos were too disparate to resolve in one proceeding in class action suit); Sheldon S. Toll, *Bankruptcy and Mass Torts: The Commission's Proposal*, 5 AM. BANKR. INST. L. REV. 363, 363 (1997) (discussing how in *Amchem*, the Court found significant conflict of interest between presently injured plaintiffs and future claimants who had not yet manifested illnesses).

⁸⁴ However, note that future claimants, by nature and by definition, cannot vote on a plan of reorganization. The Bankruptcy Code does not require that a future claims' representative approve the section 524(g) trust or the overall plan. See 11 U.S.C. § 524(g) (2000); S. Elizabeth Gibson, *Response to Professor Resnick: Will This Vehicle Pass Inspection?*, 148 U. PA. L. REV. 2095, 2113–16 (2000) (addressing due process and fairness concerns associated with future claimants' interests in reorganization plans); Inselbuch, *supra* note 68, at 1040–41 (discussing limited rights of future claimants under section 524(g)).

⁸⁵ See, e.g., Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 18–19, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524) (noting claimant's participation in settlement agreement required only "a sworn statement that the Claimant was exposed to an asbestos-containing product manufactured, sold, or distributed by Congoleum"); see also Ryan Kathleen Roth, Note, *Mass Tort Malignancy: In the Search for a Cure, Courts Should Continue to Certify Mandatory, Settlement Only Class Actions*, 79 B.U. L. REV. 577, 604–05 n.158 (1999) (stating future claimants would have to establish claim based on far stricter criteria than that required by tort law, forcing claimants to prove (1) specific compensable medical condition and (2) occupational exposure to asbestos products).

⁸⁶ See 11 U.S.C. § 502(a) (2000) ("A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects."); *In re Jorczak & Jorczak*, 314 B.R. 474, 480 (Bankr. D. Conn. 2004) (citing 11 U.S.C. § 502(a) in discussing necessary conditions for presumption of "proof of claim" and effect of presumption in establishing prima facie case); *In re New Power Co.*, 313 B.R. 496, 507 (Bankr. N.D. Ga. 2004) (citing 11 U.S.C. § 502(a) for proposition that once proof of claim is filed, claim will be allowed unless party in interest objects).

claimants with malignant injuries.⁸⁷ This is similar to the claims processing procedure in mass trials in some state courts.⁸⁸ While the practice may be common (if no less problematic) in state court, it is proscribed in bankruptcy court by the Code's restrictions on discrimination.

V. NON-COMPLIANCE WITH THE CODE'S PROCEDURAL REQUIREMENTS

A. Pre-petition Cutoff Dates

In a chapter 11 bankruptcy case, claims are distinguished, among other bases, by whether they arose pre-petition or post-petition. With certain caveats that are not relevant to this discussion, a "creditor" is defined in the Bankruptcy Code as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."⁸⁹ In other words, all entities with pre-petition claims against the debtor—no matter how close to the filing of the petition those claims arose—are entitled to the rights and protections granted to "creditors" by the Code. Significantly, for a plan to be confirmed, creditors must accept it.⁹⁰

Yet in pre-packaged asbestos bankruptcies, some claims are settled prior to the petition date and paid from a pre-petition trust. In *J.T. Thorpe*, this trust was funded with proceeds from settlements with insurers.⁹¹ In *Combustion Engineering*, the trust was funded with half of the assets of Combustion Engineering and a note from its parent, ABB.⁹² It has become common in pre-packaged bankruptcies for the pre-petition trusts to pay only a portion of the claims settled pre-petition so that the settling plaintiffs retain a claim against the debtor and therefore are entitled to vote on a proposed plan of reorganization in the ensuing bankruptcy.⁹³

⁸⁷ See Mark A. Behrens, *Some Proposals For Courts Interested in Helping Sick Claimants and Solving Serious Problems in Asbestos Litigation*, 54 BAYLOR L. REV. 331, 350 (2002) ("In the settlement . . . the high potential jury-award value of the impaired claims is spread, at least partially to the unimpaired. The arithmetic is straightforward: the unimpaired and the attorneys who receive contingent fees benefit at the expense of impaired victims."); Rothstein, *supra* note 6, at 9 (indicating practice of consolidating claims of unimpaired claimants with claims of ill claimants tends to overcompensate relatively unimpaired at expense of very sick); cf. John W. Ames & Andrew D. Stosberg, *The Latest on Reform Efforts to Curtail Asbestos Tort Litigation*, 22 AM. BANKR. INST. J. 18, 18 (2003) (discussing goal of proposed "Asbestos Claims Criteria and Compensation Act of 2003" to prevent recovery by non-malignant plaintiffs who have not yet shown signs of any illness).

⁸⁸ See Behrens, *supra* note 87, at 350 (discussing *Cosey v. E.D. Bullard Co.*, Mississippi state court case that author believes to be "one of the most notable mass consolidations"); Rothstein, *supra* note 6, at 9 (indicating state courts lack coordination since some segregate claims by unimpaired claimants while others consolidate claims of unimpaired claimants with severely ill claimants). See generally *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 821 (1999) ("[T]he elephantine mass of asbestos cases . . . defies customary judicial administration and calls for national legislation.").

⁸⁹ 11 U.S.C. § 101(10)(A) (2000).

⁹⁰ See 11 U.S.C. § 1126(c) (2000) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, . . . that have accepted or rejected such plan."); *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 457 (1999) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988)) (indicating "it is up to creditors—and not courts—to accept or reject reorganization plan"); cf. Hon. Conrad B. Duberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347, 354 n.39 (1993) (suggesting because unanimous acceptance of plan by creditors is not required by chapter 11, this may be motivating factor in deciding to file chapter 11 petition rather than settling with creditors out of court).

⁹¹ See Disclosure Statement Aug. 13, 2002 Pre-Petition Date Solicitation of Votes with Respect to the Pre-Packaged Plan of Reorganization of J T Thorpe Company at Settlement Agreement Between JT Thorpe Company and Various Asbestos Claimants § III(C), Exhibit H, *In re J.T. Thorpe Co.*, 308 B.R. 782 (Bankr. S.D. Tex. 2002) (No. 02-41487) ("It is the expectation of . . . [the debtor] that the Secured Claims shall be paid entirely out of the Insurance Proceeds.").

⁹² See Transcript of Hearing Before Honorable Judith K. Fitzgerald United States Bankruptcy Court Judge at 301, *In re Combustion Eng'g, Inc.*, 292 B.R. 515 (Bankr. D. Del. 2003) (No. 03-10495); *In re Combustion Eng'g, Inc.*, 292 B.R. 515, 519 (Bankr. D. Del. 2003) (stating debtor assigned note in favor of debtor from parent corporation to trust which had balance payable of \$300 million).

⁹³ See Plevin, *supra* note 25, at 900. For details of Combustion Engineering's pre-packaged bankruptcy, see ABB LTD., Press Release, *ABB and Combustion Engineering Reach Asbestos Agreement*, at <http://www.abb.com/global/brabb/brabb151.nsf!OpenDatabase&db=/global/brabb/brabb155.nsf&v=1D9E&e=us&c=6B247E5AB5A9FFB03256DB9004A0D46> (Jan. 17, 2003).

In *Shook & Fletcher*, the debtor granted the pre-petition trustee a security interest in Shook & Fletcher's rights to and proceeds of its insurance policies.⁹⁴ Those current asbestos claimants who entered into the "SBNP Settlement Agreement" could opt for payment of "Shook & Fletcher's share" of the settlement amount, secured by the insurance collateral and to be paid by the pre-petition trust, or to have the amount of their claims determined in accordance with a matrix, seventy-five percent of which amount would be secured by the insurance collateral and paid by the pre-petition trust.⁹⁵ Similarly, participants in the "Claimants Agreement" were allowed a secured claim equal to the lesser of the claimant's pro rata share of \$63.6 million or seventy-five percent of his or her settlement amount.⁹⁶ In either case, the remaining portion of the claim was unsecured.⁹⁷

In *J.T. Thorpe*, the obligation to pay settled claims was secured by the right to receive future insurance proceeds, limited to seventy-five percent of the amount of settlement, with the remainder of the settlement amount to be asserted as an unsecured claim in the bankruptcy case.⁹⁸ *Combustion Engineering* divided claimants into three categories according to when (and if) their claims were settled; it paid between seventy-five and ninety-five percent of the amount of their claims out of the trust, with the remaining five to twenty-five percent to be asserted as an unsecured claim in the bankruptcy case.⁹⁹ Finally, Congoleum awarded security interests in insurance proceeds to claimants opting for pre-petition settlement. While some claimants were secured for the full amount of their settled claims, others received a security interest only to the extent of seventy-five percent of their claims.¹⁰⁰

Combustion Engineering filed its bankruptcy petition on February 17, 2003, but solicited votes on its pre-packaged plan only from those asbestos claimants who had made their claims known to the debtor before November 14, 2002.¹⁰¹ Claimants were eligible for settlement and payment out of the pre-petition settlement trust only if they had a claim on file by that date.¹⁰² Similarly, *Shook & Fletcher* established cutoff dates of March 1, 2002 and April 1, 2002, respectively, for participation in the SBNP Settlement Agreement and Claimants' Agreements, but did not file its petition in bankruptcy until April 8, 2002;¹⁰³

⁹⁴ See Disclosure Statement at 16, *In re Shook & Fletcher Insulation Co.* (Bankr. N.D. Ala. 2002) (No. 02-02771). See generally Roger Parloff, *Welcome to the New Asbestos Scandal*, FORTUNE, Sept. 6, 2004 at 186 (discussing insurance implications in asbestos litigation); Kami E. Quinn, *Insurance You Can Trust; Liability Policies Are Key to Resolving Mass Torts with Bankruptcy Funds*, LEGAL TIMES, Apr. 26, 2004 at 42 (exploring beneficial possibilities with respect to resolution of insurance assets in bankruptcy).

⁹⁵ See Disclosure Statement at 15, *In re Shook & Fletcher Insulation Co.* (Bankr. N.D. Ala. 2002) (No. 02-02771) (explaining two ways claimants may opt to have their claims treated).

⁹⁶ *Id.* at 18.

⁹⁷ *Id.* at 15.

⁹⁸ See Disclosure Statement Aug. 13, 2002 Pre-Petition Date Solicitation of Votes with Respect to the Pre-Packaged Plan of Reorganization of J. T. Thorpe Company at Collateral Trust Agreement, Exhibit G, § II(A), *In re J.T. Thorpe Co.*, 308 B.R. 782 (Bankr. S.D. Tex. 2002) (No. 02-41487) ("Each Participating Claimant under the Claimant Agreement shall have a secured claim . . . equal to . . . 75% of the Participating Claimant's Settlement Amount."). See generally Plevin, *supra* note 25, at 892-98 (discussing settlement involved in *In re J.T. Thorpe Co.*)

⁹⁹ *In re Combustion Eng'g, Inc.*, 295 B.R. 459, 466-67 (Bankr. D. Del. 2003); see also Pasquale, *supra* note 24, at 1-3, 42 (stating trust paid category 1 claimants 95% of value of claim, category 2 claimants 85% of value of claim, and category 3 claimants 75% of value of claim).

¹⁰⁰ See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 24, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524) (explaining those claimants who settled prior to filing date were secured for 100% for their claims and those claimants who filed before date specified in Claimants Agreement were secured for 75% of their claims). According to Congoleum's insurers, pre-petition cutoff dates encourage the early filing of claims by the sophisticated plaintiff's lawyers who are familiar with the cutoffs. *Id.* at 22 n.16 ("The sophisticated plaintiffs' bar is well aware of the importance of filing claims soon enough so they will be paid under the pre-bankruptcy trust."); see Plevin, *supra* note 25, at 891-92 (reviewing details of pre-petition trust set up).

¹⁰¹ See *In re Combustion Eng'g, Inc.*, No. 03-3392, 2004 WL 2743565, at *4 (3d Cir. 2004).

¹⁰² See *id.* ("Non-participating . . . claimants were left to recover in the bankruptcy proceeding."); see also Plevin, *supra* note 25, at 901 (explaining claimants in Payment Category 1, which consisted of fully settled claimants as of Nov. 14, 2002, were only claimants due payment as of Nov. 14, 2002).

¹⁰³ For example, a March 1, 2002 deadline was established for participation in the "SBNP Settlement Agreement." See Disclosure Statement Feb. 18, 2002 Pre-Petition Date Solicitation of Votes with Respect to the Prepackaged Plan of Reorganization of Shook & Fletcher Insulation Co, Index of Defined Terms, *In re Shook & Fletcher Insulation Co.* (Bankr. N.D. Ala. Feb. 25, 2002) (No. 02-02771).

Congoleum's August 15, 2003 cutoff date was more than four months pre-petition.¹⁰⁴ This practice of establishing pre-petition cutoff dates—which may not be communicated to all eligible claimants—has the effect of disenfranchising all non-participating claimants. Even if their claims arose pre-petition, these present claimants are treated as holders of future demands. Therefore, they are deprived of their statutory right to vote on the plan and must depend on the Future Claimants' Representative to protect their rights.

This pre-petition cutoff finds no support in the Bankruptcy Code. On the contrary, it impermissibly and arbitrarily discriminates among similarly situated claimants. The disclosure statement must be "transmitted to each holder of a claim."¹⁰⁵ As noted, "creditors" are entitled to vote on the plan; however, holders of claims in the *Combustion Engineering* case who did not register with the debtor prior to November 14, 2002 did not receive disclosure statements and were not allowed to vote on the plan. The pre-petition cutoff violates the clear strictures of the Bankruptcy Code, and its effect is to disenfranchise claimants who filed claims after the cutoff date. This is an end-run around the classification and discrimination provisions of the Bankruptcy Code. A plan may not separately classify settling and non-settling claimants and pay them differently, yet this is precisely the effect of the pre-petition cutoff.

Despite the lack of statutory support for, and the clear discriminatory effect of, the pre-petition cutoff, the court in *Combustion Engineering* approved of the cutoff:

The purpose of the CE Settlement Trust was to compensate people who already had claims in the tort system or on file with CE and to provide CE with a reprieve from litigation. In order to do that, a cutoff had to be established to prevent a huge influx of claims once the MSA was set up. As Mr. Rice testified, if you announce that you have a fund of money, everyone will come forward with claims in an attempt to obtain part of that fund.¹⁰⁶

While this may be a persuasive rationale, it is entirely at odds with the Bankruptcy Code's requirement that unless every pre-petition claimant is permitted to "come forward" on an equal basis, no one is able to.

There is only one circumstance in which a pre-petition cutoff date may lawfully be established. The Bankruptcy Rules permit the establishment of a record date for security holders: a debt or equity security holder who accepts or rejects the plan prior to the filing of the petition must have been the holder of record of the security on the record date in order for its vote to be counted.¹⁰⁷ This is the only legal authority for the proposition that arbitrary pre-petition claims bar dates may be permissible. But that legal authority does not, and should not, extend to asbestos claimants, because of the competing interests among them. The interests of present and future claimants are directly adverse to one another as they are playing a zero-sum game; each dollar paid to a present claimant is a dollar less paid to future claimants. The Supreme Court recognized this conflict in denying class certification in *Amchem*: "In significant respects, the interests of those within the single class are not aligned. Most saliently, for the currently injured, the critical goal is generous immediate payments. That goal tugs against the interest of exposure-only plaintiffs in ensuring an ample, inflation-protected fund for the future."¹⁰⁸ This conflict is

¹⁰⁴ See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 23–24, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524) (listing Dec. 31, 2003 as date chapter 11 cases were commenced and Aug. 15, 2003 as cut-off date, specified in Claimants Agreement, to file claim so as to acquire secured claim); see also Daniel Hays, *Asbestos Bankruptcies Plague Insurers: Do Pre-packaged Arrangements Deprive Carriers of right to Defend against Claims?*, NAT'L UNDERWRITER-PROP. & CASUALTY, May 10, 2004, at 13 (addressing timetable of cut-off dates set forth in Congoleum).

¹⁰⁵ 11 U.S.C. § 1125(c) (2000); see 7 COLLIER ON BANKRUPTCY ¶ 1126.03[2][d] (Lawrence P. King et al. eds., 15th ed. rev. 1997) (explaining pre-petition solicitation of votes is not provided for in Bankruptcy Code).

¹⁰⁶ *In re Combustion Eng'g*, 295 B.R. 459, 469 (Bankr. D. Del. 2003); cf. Vairo, *supra* note 18, at 114 (stating need for setting bar date in Dalkin Shield case was "obvious," because of need to determine extent of liability).

¹⁰⁷ FED. R. BANKR. P. 3018 (1997); *In re OBT Partners*, 214 B.R. 863, 869 (Bankr. N.D. Ill. 1997) (stating Rule 3018 allows equity security holder to vote only if he/she is shareholder on date of order approving disclosure statement); *In re Union Meeting Partners*, 178 B.R. 664, 670 (Bankr. E.D. Pa. 1995) (noting Rule 3018(a) establishes bankruptcy equivalent of record date).

¹⁰⁸ *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 626 (1997).

demonstrated by the separate representation of present and future claimants in a traditional asbestos bankruptcy. Present claimants are represented by their own attorneys as well as by a court-approved committee for asbestos claimants, while future claimants are represented by the future claimants' representative. Present claimants who do not assert claims by the arbitrary pre-petition cutoff date but are capable of identifying themselves and securing representation should not be subject to a "representative" intended to represent the interests of future claimants who are unknown and have no other way of being represented, and who have different interests than present claimants.

VI. VOTING OF CLAIMS SETTLED PRE-PETITION

Even if a pre-petition settlement is not expressly contingent upon an affirmative vote for the plan, the pre-petition settlement is tied to voting on the plan because of the unsecured claims that the settling claimants retain. Because claimants retain these stub claims, they are entitled to vote on the plan. Those who vote to accept the plan contribute to the seventy-five percent affirmative vote needed to confirm the plan and effectuate the channeling injunction. The result is the purchase of votes to accept a plan that promises even minimal payouts on unsecured claims. This strategy worked in both *J.T. Thorpe* and *Combustion Engineering*, whose plans were each accepted by over ninety-nine percent of asbestos claimants (as defined by the plan).¹⁰⁹ Similarly, in *Congoleum*, the claims reviewer notified claimants in advance of the voting deadline as to whether their claims were approved, giving claimants the opportunity to remedy any deficiencies in advance of voting.¹¹⁰ The effect of the pre-petition cutoff, of course, was to skew voting and to disenfranchise creditors who assert claims after the cutoff date.

Depending upon the terms of the pre-petition settlement, the right to vote the "stub" claim in bankruptcy may be doubtful. In *Combustion Engineering*, parties to the settlement agreement agreed to accept a "settlement amount" in full satisfaction of their claims. Pursuant to the agreement, Combustion Engineering was "liable" for that amount, and the greater portion of that amount would be paid by the pre-petition trust. The agreement further provided that the claimants' sole remedy would be the settlement procedures,¹¹¹ which in turn, precluded claimants from seeking to recover any part of their claims from the debtor. Claimants could only file a proof of claim in the bankruptcy case; they retained that right pursuant to the express terms of the settlement agreement.¹¹² Indeed, confirmation of the plan depended upon their filing proofs of claims and voting to accept the plan as holders of allowed claims.

Only holders of allowed claims are entitled to vote on plans of reorganization.¹¹³ However, a claim cannot be allowed if it "is unenforceable against the debtor and property of the debtor, under any agreement or applicable law."¹¹⁴ While the United States Supreme Court has rejected the argument that

¹⁰⁹ See Plevin, *supra* note 25, at 896 (finding J.T. Thorpe's plan was accepted by over 99% of asbestos claimants); ABB LTD., Press Release, *ABB and Combustion Engineering Reach Asbestos Agreement*, at <http://www.abb.com/global/brabb/brabb151.nsf!OpenDatabase&db=/global/brabb/brabb155.nsf&v=1D9E&e=us&c=6B247E5AB5A9FFB03256DB9004A0D46> (Jan. 17, 2003) (tallying 103,000 votes for plan confirmation and 1,000 against plan confirmation).

¹¹⁰ See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 22-23, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524) (explaining giving advance notice of claim approval/rejection allowed impaired "claimholders . . . to withhold their favorable vote until they had been notified whether . . . [the 'claims reviewer'] approved their claims").

¹¹¹ Master Settlement Agreement at 6, *In re Combustion Eng'g, Inc.*, 295 B.R. 459 (Bankr. D. Del. 2003), at http://bankruptcy.motleyrice.com/bankruptcy_ce_relevant_documents.asp (last visited Dec. 22, 2004) (providing each asbestos claimant agrees settlement procedures shall be "sole and exclusive remedy" of his/her claims against debtor).

¹¹² See *id.* (stipulating claimants may only file proof of claim in bankruptcy).

¹¹³ 11 U.S.C. § 1126(a) (2000) (providing holder of allowed claim may accept or reject plan); see *In re Gardinier, Inc.*, 55 B.R. 601, 604 (Bankr. M.D. Fla. 1985) (explaining any claim of creditor that is disputed and has objection pending is not an allowed claim and therefore not ordinarily entitled to vote on plan reorganization).

¹¹⁴ 11 U.S.C. § 502(b)(1) (2000) (codifying disallowance of claim when unenforceable against debtor); see *United States v. Sanford (In re Sanford)*, 979 F.2d 1511, 1513 (11th Cir. 1992) (ruling claim against bankruptcy estate not allowed if claim would not be enforceable).

the post-petition debtor-in-possession is a separate entity from the pre-petition debtor,¹¹⁵ the debtor-in-possession is a separate legal entity from the post-petition bankruptcy estate.¹¹⁶ It follows that if a debtor and its creditor agree pre-petition that the creditor may not assert a claim against the debtor, the claim should not be allowed in bankruptcy.¹¹⁷ It would run contrary to both the text and the purpose of section 502(b)(1) if a debtor were permitted to shield itself from exposure to a claim outside of bankruptcy while its creditors in bankruptcy were forced to share with the holder of that claim.

As with the pre-petition cutoff date, this issue is significant because the improperly voted claims counted towards the seventy-five percent acceptance amount for confirmation of the plan and establishment of the section 524(g) trust and channeling injunction. In effect, the debtor solicited votes for the plan by offering pre-petition settlements, to be paid via the pre-petition trust, even though the settlement absolved the debtor itself from any further liability. ACandS, in its own bankruptcy case, euphemistically defended this practice as "an attempt to buy time and build consensus."¹¹⁸

VII. FUNDING OF THE TRUST WITH VALUELESS ASSETS: DISTORTING THE PURPOSE OF 524(G)

As discussed above, the *Manville* trust was funded with insurance settlement proceeds, cash, receivables, stock of the reorganized company, bonds, and long term notes. Manville was also to contribute up to twenty percent of its profits to the trust as long as needed to continue paying claims (the plan contemplated thirty years of payments).¹¹⁹ Section 524(g) expands upon the *Manville* procedure by permitting the channeling injunction to extend not only to the debtor, but also to its parent or subsidiary (as identified in the plan).¹²⁰ This section also expands the potential means of funding the trust: the trust must be capable of owning a majority of the shares of some entity, but that entity need not be the debtor; it can be its parent or subsidiary.¹²¹ Furthermore, the trust "is to be funded in whole or in part by the securities of 1 or more debtors involved in such plan and by the obligation of such debtor or debtors to

against debtor outside of bankruptcy); *Werth v. Interstate Bank of Denver N. A. (In re Werth)*, 54 B.R. 619, 624 (D. Colo. 1985) (holding bank's claim against debtor unenforceable where bank breached contract with debtor).

¹¹⁵ See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (finding debtor-in-possession, as same entity as pre-petition debtor, may reject collective bargaining agreement and may unilaterally alter or terminate any provision of collective bargaining agreement).

¹¹⁶ See 11 U.S.C. § 101(13) (2000) (defining "debtor" as person or municipality concerning which a case has been commenced); 11 U.S.C. § 541(a) (2000) (describing creation and composition of estate); *In re Quinn*, 299 B.R. 450, 454 (Bankr. W.D. Mich. 2003) ("The bankruptcy estate is a legal entity which is separate from the debtor."); 5 COLLIER ON BANKRUPTCY ¶ 541.03 (Lawrence P. King et al. eds., 15th ed. rev. 1997) ("A non-individual debtor continues to exist as a legal entity after the filing of a petition Yet section 541(a) creates the bankruptcy estate, which assumes all of the property interests of the debtor, including any business of the debtor.")

¹¹⁷ 11 U.S.C. § 502(b)(1) (announcing claims may be made unenforceable under any agreement); see *In re Strangis*, 67 B.R. 243, 246 (Bankr. D. Minn. 1986) (finding "language regarding disallowance of a claim" in section 502(b)(1) relates to pre-petition enforceability); 5 COLLIER ON BANKRUPTCY ¶ 502.03[2][b][i] (Lawrence P. King et al. eds., 15th ed. rev. 1997) (noting creditor claim against debtor disallowed where pre-petition agreement prohibits such claim).

¹¹⁸ See *Objection to Certain Proposed Findings of Fact and Conclusions of Law re Chapter 11 Plan Confirmation Pursuant to Bankruptcy Rule 9033 and Mot. to Confirm Plan of Reorganization at 29, In re ACandS, Inc.*, 311 B.R. 36 (Bankr. D. Del. 2004) (No. 02-12687).

¹¹⁹ See *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 640 (2d Cir. 1998) (describing Manville trust and debtor's contribution of twenty percent of yearly profits); Peter E. Meltzer, *Getting Out of Jail Free: Can the Bankruptcy Plan Process Be Used to Release Nondebtor Parties?*, 71 AM. BANKR. L. J. 1, 28 (1997) (exploring "Asbestos Health Trust" created in *In re Johns-Manville Corp.*); *supra* notes 38–40 and accompanying text.

¹²⁰ See 11 U.S.C. § 524(g)(4)(A)(ii) (2000); 5 COLLIER ON BANKRUPTCY ¶ 524.07 (Lawrence P. King et al. eds., 15th ed. rev. 1997) (stating section 524(g) modeled on John–Mansville injunction); Meltzer, *supra* note 119, at 31 (stating section 524(g) approved form of injunction pursuant to Manville plan); see also Toll, *supra* note 83, at 375–76 (describing channeling injunction first used in Manville under section 524(g) as protecting third parties).

¹²¹ See 11 U.S.C. § 524(g)(2)(B)(i)(III) (specifying requirement of owning majority of voting shares in either debtor corporation, parent of debtor corporation, or in subsidiary of debtor); 5 COLLIER ON BANKRUPTCY ¶ 524.07 (stating trust must control majority of voting shares of debtor).

make future payments, including dividends."¹²² Subject to the requirement that the debtor show that it is "likely to be subject to substantial future demands,"¹²³ an asbestos company has leeway in placing an affiliate into bankruptcy and itself taking advantage of the third party injunction.

A recent article describes in some detail how an otherwise financially sound company facing asbestos liability might attempt to take advantage of section 524(g) with minimal disruption to its business, shareholders and creditors by strategic formation and use of shell affiliates.¹²⁴ Authors Todd R. Snyder and Deanne C. Siemer describe a procedure, dubbed the "Patronus Technique," whereby "a large public company with significant asbestos liability somewhere in its corporate family but an otherwise healthy capital structure and competitive operations"¹²⁵ creates a special-purpose subsidiary to which the parent may transfer asbestos liability.¹²⁶ The subsidiary then enters bankruptcy to take advantage of the section 524(g) injunction, funding the trust with assets contributed also by the parent company.¹²⁷ The Patronus Technique is intended to maximize value to business creditors as well as asbestos claimants by permitting the asbestos defendant to operate outside of bankruptcy; the critical feature of the technique is that the non-debtor parent retains "its key businesses and assets so that customers, trade creditors and financial lenders will not exact a bankruptcy penalty or bankruptcy related risk premium."¹²⁸ The goal is to achieve "the same result as a mandatory class action, binding on all tort claimants, and nothing more."¹²⁹

Whether the Patronus Technique is permissible under the Code or whether it is sound on a more basic level is not for this article to debate. What is clear is that this result is not what Congress had in mind when it enacted section 524(g). Section 524(g) requires that the trust be funded with the debtor's securities; this requirement would be meaningless if it could be satisfied by a contribution of essentially worthless shares of a shell company. Nevertheless, it has become common for large companies to send their affiliates into bankruptcy rather than having themselves seek protection. Halliburton is one example; concerned about its market capitalization, it sent eight of its subsidiaries into chapter 11 in lieu of filing its own bankruptcy petition.¹³⁰ RHI Refractories Holding Co. also remained outside of chapter 11

¹²² 11 U.S.C. § 524(g)(2)(B)(i)(II); see *In re Combustion Eng'g*, 295 B.R. 459, 489 (noting section 524(g) trust funded by debtor's securities and obligation to make future payments). See generally 5 COLLIER ON BANKRUPTCY ¶ 524.07 (explaining funding of trust under section 524(g)).

¹²³ 11 U.S.C. § 524(g)(2)(B)(ii)(I); see *In re Western Asbestos Co.*, 313 B.R. 832, 849–50 (Bankr. N.D. Cal. 2003) (confirming injunction pursuant to section 524 requires finding debtor is likely to be subject to substantial future demands for payment). See generally Meltzer, *supra* note 119, at 32 n.113 (mentioning requirement of section 524(g)(2)(B)(ii) is due to long gestation period of asbestosis which prevents future claimants from being known at time of bankruptcy).

¹²⁴ See Todd R. Snyder & Deanne C. Siemer, *The Patronus Technique: A Practical Proposal for Asbestos-Driven Bankruptcies*, 11 J. BANKR. L. & PRAC. 357 (2002).

¹²⁵ *Id.* at 372.

¹²⁶ *Id.* at 372–73; see also Kenneth S. Rivlin & Jamaica D. Potts, *Not So Fast: The Sealed Air Asbestos Settlement and Methods of Risk Management in the Acquisition of Companies with Asbestos Liabilities*, 11 N.Y.U. ENVTL. L.J. 626, 657 (2003) (noting special purpose subsidiaries may also be used as vehicles for mitigating buyer responsibility when acquiring companies with asbestos liability); cf. Katherine D. Kale, *Securitizing the Enterprise: Enterprise Liability and Transferred Receivables in Bankruptcy*, 20 BANKR. DEV. J. 311, 312 (2003) (remarking in order to keep bankruptcy risk of subsidiary separate from that of parent, assets must be transferred through "true sale," whereby parent retains no legal or equitable interest in assets).

¹²⁷ See Snyder & Siemer, *supra* note 124, at 372–75.

¹²⁸ *Id.*; see, e.g., Plevin, *supra* note 25, at 891 (describing Halliburton's plan to send certain subsidiaries into bankruptcy and invoke section 524 injunctions to resolve asbestos liability); see also *In re Combustion Eng'g*, 295 B.R. 459, 481 (Bankr. D. Del. 2003) (explaining injunction under section 524 will bar all claims against parent company).

¹²⁹ Snyder & Siemer, *supra* note 124, at 357 (analogizing reorganization to mandatory class actions because reorganization can be structured to affect only one class of claims, thereby minimally impacting other claims). But see Kevin H. Hudson, *Catch-23(b)(1)(B): The Dilemma of Using the Mandatory Class Action to Resolve the Problem of the Mass Tort Case*, 40 EMORY L.J. 665, 696–97 (1991) (distinguishing mandatory class actions from bankruptcy proceedings and explaining why mandatory class actions are superior alternatives to bankruptcy proceedings when dealing with mass tort claims).

¹³⁰ See Order Affirming Order Confirming Plan of Reorganization, *In re Mid-Valley, Inc.*, 305 B.R. 425 (Bankr. W.D. Pa. 2004) (No. 03-35592) (ordering, "pursuant to 11 U.S.C. § 524(g)(3)(A), the Amended Order Confirming Plan of Reorganization issued by the Bankruptcy Court and dated July 21, 2004, at Bankruptcy Docket No. 1716, is AFFIRMED *nunc pro tunc* to July 16, 2004"); see also *Pennsylvania Federal Judge Approves Bankruptcy Plan for Halliburton Units*, 4-1 MEALEY'S ASBESTOS BANKR. REP. 1 (2004) (listing seven of eight Halliburton subsidiaries under amended bankruptcy reorganization plan and detailing specifics of such plan).

by seeking bankruptcy protection for two of its subsidiaries.¹³¹ Similarly, ABB took advantage of the channeling injunction by sending Combustion Engineering, an affiliate whose business had been pared down to the extent that its sole operations were owning and leasing a single parcel of real estate, into bankruptcy.¹³² While ABB contributed some of its shares of stock to the trust, the trust was also funded with the arguably worthless stock of Combustion Engineering.¹³³

VIII. ASBESTOS LITIGATION AND BANKRUPTCY PROTECTIONS: PRE-PETITION NEGOTIATIONS

When a company files for bankruptcy protection, its creditors, at least in theory, also receive protection. Along with the Code's protections against discrimination among creditors, in a conventional (i.e., not pre-packaged) asbestos bankruptcy case, claimants' interests at all stages are represented not only by their lawyers, but also by court-approved representatives. An official asbestos claimants' committee represents known asbestos claimants;¹³⁴ a future claimants' representative represents the interests of unknown claimants who will seek redress against the trust.¹³⁵ Finally, the United States Trustee oversees the entire bankruptcy proceeding.¹³⁶

Outside of bankruptcy, asbestos claimants do not have the benefit of these protections because they are represented solely by their attorneys (if they have retained attorneys). Future claimants have no

¹³¹ See Behrens, *supra* note 87, at 339 ("In the first quarter of 2002, RHI Refractories Holding Co., the world's leading producer of refractory materials for the steel industry, was forced to seek bankruptcy protection for two of its U.S. subsidiaries (Harbison-Walker Refractories Co. and North American Refractories Co.) as a result of asbestos liability claims."); Susan Power Johnson & Katherine Porter, *Extension of Section 524(g) of the Bankruptcy Code to Nondebtor Parents, Affiliates, and Transaction Parties*, 59 BUS. LAW. 503, 519–20 (2004) (acknowledging RHI Refractories Holding Co. as parent company of Harbison-Walker Refractories Co. and North American Refractories Co. and recognizing Halliburton's utilization of Harbison-Walker's section 524(g) trust as leverage for settlements with asbestos claimants regarding its own subsidiaries); see also Alexei Barrionuevo, *Halliburton's Asbestos Liability May Gain Clarity as Harbison Files for Chapter 11*, WALL ST. J., Feb. 15, 2002, at A2 (mentioning Harbison-Walker Refractory Co.'s and North American Refractories Co.'s filing for chapter 11 protection and noting Harbison-Walker's intention to negotiate protective trust for pending and future asbestos claims); William Hall, *Asbestos Claims Force RHI to Seek Protection for U.S. Arm*, FIN. TIMES, Jan. 8, 2002, at 28 (informing North American Refractories Co., one of RHI's three subsidiaries, filed for chapter 11 protection under Bankruptcy Code).

¹³² See Johnston & Porter, *supra* note 131, at 518 (detailing channeling injunction's protection to ABB and its two nondebtor affiliates); Pasquale, *supra* note 24, at 42 (explaining Combustion Engineering Inc.'s proposed pre-packaged reorganization plan and disclosure statement based on section 524(g) of Bankruptcy Code); Vairo, *supra* note 18, at 107 (indicating ABB group negotiated "with representatives of U.S. asbestos personal injury plaintiffs to resolve the asbestos liability of its United States subsidiary Combustion Engineering (CE) by reorganizing CE under Chapter 11 in a prepackaged bankruptcy plan").

¹³³ See Pasquale, *supra* note 24, at 43 (noticing certain parties objected to confirmation of Combustion Engineering Inc.'s pre-packaged bankruptcy plan by arguing "because Combustion ceased operations pre-petition, its stock [was] 'worthless and provide[d] no future economic benefit to creditors from future operations'"); see also Johnston & Porter, *supra* note 131, at 518–19 (recognizing Combustion Engineering Plan would entail ABB's assumption of Combustion Engineering's environmental liabilities, including "\$20 million note convertible to eighty percent of Combustion Engineering stock"). *But see* Pasquale, *supra* note 24, at 43 (explaining bankruptcy court and district court rejected critics' arguments of Combustion Engineering Inc.'s stock being worthless).

¹³⁴ See 11 U.S.C. § 1102 (2000) ("United States trustee shall appoint a committee of creditors holding unsecured claims," and defining, among other things, what persons would ordinarily make up such committee); see also Michael A. Gerber, *Commentary: The Election of Directors and Chapter 11—The Second Circuit Tells Stockholders to Walk Softly and Carry a Big Lever*, 53 BROOK. L. REV. 295, 332 (1987) (exemplifying *In re Johns-Manville Corp.* as case in which numerous committees were appointed in bankruptcy proceeding pursuant to section 1102(a) of Bankruptcy Code); Kenneth N. Klee & K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. REV. 995, 1024–27 (1993) (engaging in discussion regarding section 1102 and its relation to appointment of multiple committees, and exemplifying *In re Sharon Steel Corp.* as situation where implementation of multiple committees was not permitted).

¹³⁵ See 11 U.S.C. § 524(g)(4)(B)(i) (2000) ("[T]he court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such kind . . ."); see also *In re Kensington Int'l Ltd.*, 368 F.3d 289, 304 (3d Cir. 2004) (acknowledging fiduciary duty owed by representative to future claimant and pointing out possible conflict of interest when present and future asbestos claimants are represented by same person or committee).

¹³⁶ See 11 U.S.C. § 307 (2000) ("The United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title . . ."). See generally *In re Pillowtex, Inc.*, 304 F.3d 246, 250 (3d Cir. 2002) (articulating rights and responsibilities United States Trustee has under 11 U.S.C. § 307).

representation. On the other hand, the asbestos defendant can act without being subjected to the oversight of the court, the United States Trustee, or official committees. While this is true of any company that is contemplating filing for bankruptcy, it is particularly troublesome in an asbestos case because of the effect of section 524(g)'s channeling injunction on the rights of future claimants, who by definition are unable to appear in the proceedings and speak on their own behalf.

These problems are exacerbated in a pre-packaged bankruptcy, where negotiations occur pre-petition, without the oversight of the bankruptcy court and without the protections afforded to claimants inside a conventional bankruptcy. Even in pre-packaged bankruptcies where a future claimants' representative ("FCR") is retained pre-petition, future claimants do not receive the benefit of a disinterested advocate. As the insurers compellingly argued in both *Congoleum* and in *Mid-Valley*, a future claimants' representative is conflicted where he was "appointed pre-petition by his adversaries ([the debtor] and Claimants' Counsel) and was paid by [the debtor] pre-petition."¹³⁷ Given this inherent conflict, it arguably violates constitutional due process to permit the FCR to retain that position after the petition is filed. Dual representation by the FCR is not the only conflict arising in pre-packaged bankruptcies. For instance, Combustion Engineering's parent agreed to pay, and did pay, plaintiffs' counsel Joe Rice a \$20 million "success fee" for his work in negotiations, while the *Congoleum* plan called for \$1 million payments each to plaintiffs' lawyers Rice and Weitz. As previously discussed, such conflicts may escape scrutiny because the parties are negotiating with insurance funds, and insurers have repeatedly been denied standing to defend their contractual rights under their policies—notably, their rights to participate in settlement.¹³⁸ The lack of insurer participation helps to explain debtors' generosity in issuing payments to their adversaries as well as the high settlements offered to asbestos claimants; it is easy to spend someone else's money, especially if the person whose money is at stake is barred from participating in the bankruptcy case.¹³⁹

IX. CONCLUSION

¹³⁷ Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 32, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524); see Hartford Insurers' Preliminary Objections to Debtors' Proposed Plan, Disclosure Statement and Plan Solicitation Procedures at 17, *In re Mid-Valley, Inc.*, 305 B.R. 425 (Bankr. W.D. Pa. 2004) (No. 03-35592); see also *In re Mid-Valley, Inc.*, 305 B.R. 425, 433 (Bankr. W.D. Pa. 2004) (rejecting, due to lack of standing, insurer objection to appointment of future claimants representative on grounds representative had conflict of interest since he was selected and paid by debtors and cannot improve position of future claimants).

¹³⁸ See *In re Mid-Valley, Inc.*, 305 B.R. at 428 (acknowledging some insurance contracts allow insurers to participate in settlement of asbestos claims, but concluding right does not constitute claim, nor standing); Plevin, *supra* note 25, at 921 (discussing rationale of procedure governing payment of post-petition claims that does not give insurers right to participate in defense or settlement of claims); see also *Certain Underwriters at Lloyd's v. McDermott Int'l, Inc.*, No. 01-912, 2002 U.S. Dist. LEXIS 278, at *4 (E.D. La. Jan. 4, 2002) (noting insurance company approved, but did not participate, in asbestos settlement which eventually paid out claims of over \$650 million).

¹³⁹ For instance, in *Congoleum* asbestos claims were settled for \$1,000 to \$3,000 each, despite the fact that the historic average for settlement of claims was approximately \$400, with 99% of claims settled under \$102. See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 17-18, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524). But see Louis DiGiovanni, Note, *New York City's Schools Asbestos Debauché: An Administrative Approach to the Problem of Faulty School Inspections and a Possible New Round of Asbestos Litigation*, 6 FORDHAM ENVTL. L.J. 79, 86 (1995) (stating in mid-1980's, average asbestos settlement ranged from \$54,000 for asbestosis to \$265,000 for mesothelioma, with average settlement of \$64,000); Kevin M. Warsh, *Corporate Spinoffs and Mass Tort Liability*, 1995 COLUM. BUS. L. REV. 675, 683 (1995) (acknowledging average asbestos-related lung cancer settlement was \$224,000 in 1992). In addition, despite the lax requirements for receiving settlement from the trust, the plan proposed to pay contingency fees of 40% or more to claimants' counsel. See Certain Insurers' Brief (i) Responding to the Affidavit of Vincent J. Sullivan and (ii) Requesting a Scheduling Conference at 31, *In re Congoleum Corp.*, 2004 WL 2339762 *1 (Bankr. D.N.J. Jan. 5, 2004) (No. 03-51524); see also Findley v. Blinken (*In re Joint E. & S. Dist. Asbestos Litig.*), 129 B.R. 710, 811 (E. & S.D.N.Y. 1991) (speculating attorney's fees and transactional costs account for 70% of money available for compensation); Lester Brickman, *On the Theory Class's Theories of Asbestos Litigation: The Disconnect Between Scholarship and Reality*, 31 PEPP. L. REV. 33, 64 n.91 (2004) (noting plaintiffs' attorney in asbestos bankruptcy proceedings still recover 40% contingency rate); Francis E. McGovern, *Resolving Mature Mass Tort Litigation*, 69 B.U. L. REV. 659, 689 (1989) (postulating excessive nature of 30% to 40% recover for plaintiffs' attorneys in asbestos cases).

Judge Wilfred Feinberg noted over a decade ago that "there is at least doubt as to whether the bankruptcy laws alone can effectively deal with the problem of future claimants in the context of mass torts whose damage may not surface for many years."¹⁴⁰ Given the evolution of asbestos bankruptcy in recent years and the proliferation of pre-packaged cases that have managed to distort those bankruptcy laws, this observation can now fairly be called an understatement. Judge Newsome's opinion in *ACandS* addresses some of the problems in recent pre-packaged asbestos cases by requiring that such pre-packs adhere to the language and intent of the Bankruptcy Code, even if there is apparent consent. Courts should follow Judge Newsome's lead in reining in these cases to ensure that both the letter and the spirit of the Bankruptcy Code are observed.

¹⁴⁰ *Findley v. Blinken (In re Joint E. & S. Dist. Asbestos Litig.)*, 982 F.2d 721, 753 (2d Cir. 1992) (Feinberg, J., concurring in part and dissenting in part); *see Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 639 (2d Cir. 1988) (noting problems with categorizing future claimants under bankruptcy laws, yet recognizing need for future claimants to be represented); *In re Johns-Manville Corp.*, 68 B.R. 618, 628 (Bankr. S.D.N.Y. 1986) (speculating whether classification of future claimants as creditors appropriate, but not deciding issue).

ADDENDUM

As this article was going to press, the United States Court of Appeals for the Third Circuit published a 136-page opinion vacating the order of the District Court for the District of Delaware that approved Combustion Engineering's pre-packaged plan.^I The opinion addressed four main topics:

1. Whether the bankruptcy court had "related to" jurisdiction over derivative and non-derivative claims against Combustion Engineering's non-debtor affiliates;
2. Whether a non-debtor may avail itself of section 105, rather than section 524(g), to cleanse itself of non-derivative asbestos liability;
3. The propriety of the voting process, in particular the "two-trust" structure and the voting of stub claims; and
4. The standing of Combustion Engineering's insurers to appeal.

On the issue of jurisdiction, the court found that the district court could not exercise "related to" jurisdiction over claims against Combustion Engineering's non-debtor affiliates. Curiously, the court skipped any discussion of whether "core" jurisdiction would apply. Arguably, the provisions of the plan purporting to enjoin non-debtor claims would fall within 28 U.S.C. § 157(2)(L), which provides that "core proceedings include, but are not limited to . . . confirmations of plans."^{II} The court, first, found that corporate affiliation was not enough, by itself, to establish "related-to" jurisdiction.^{III} Second, the fact that a plan depends upon third-party contributions does not confer jurisdiction over the contributors: "If that were true, a debtor could create subject matter jurisdiction over any non-debtor third party by structuring a plan in such a way that it depended upon third-party contributions."^{IV} Third, there was not a unity of interest between Combustion Engineering, on the one hand, and the non-debtors, on the other, sufficient to find jurisdiction on a "related liability" theory.^V Finally, the allegation that the parties shared insurance was insufficient where there were insufficient factual findings in the record.^{VI}

With respect to the use of section 105(a), under which the bankruptcy court had enjoined the non-debtor, non-derivative claims, the court held that section 105(a) could not extend the channeling injunction to non-debtors where the requirements of section 524(g) were not met.^{VII} As the non-debtors were subsidiaries, not parents, of the debtor, section 524(g) did not apply. In light of the fact that the Bankruptcy Code contained a provision for asbestos channeling injunctions, i.e., section 524(g)–section 105(a) would not permit the Court to issue such injunctions outside of the

^I See *In re Combustion Eng'g, Inc.*, No. 03-3392, 2004 U.S. App. LEXIS 24834, at *1 (3d Cir. Dec. 2, 2004).

^{II} 28 U.S.C. § 157(2)(L) (2000).

^{III} *In re Combustion Eng'g, Inc.*, 2004 U.S. App. LEXIS 24834, at *89.

^{IV} *Id.* at *90.

^V See *id.* at *99–*102.

^{VI} *Id.* at *105–07.

^{VII} *Id.* at *108.

requirements of section 524(g).^{VIII} Although this holding may not be consistent with legislative intent, its effect may be to discourage use of the Patronus Technique or similar restructurings.

The court discussed several points concerning the two-trust structure of the reorganization and the voting of stub claims. The Court expressed its belief that the pre-petition payments to the settlement trust may constitute avoidable transfers pursuant to section 547(b).^{IX} The Court remanded on the issue of whether asbestos claimants would have received more under a chapter 7 plan than under the pre-petition settlement.^X The court further expressed reservations about the disparity in treatment among stub holders and settling claimants in light of the pre-pack bankruptcy as a whole.^{XI} Finally, the court noted the "two considerations here that are absent in the ordinary commercial bankruptcy: the Plan's treatment of current asbestos claimants relative to future asbestos claimants, and its treatment of malignant asbestos claimants relative to non-malignant asbestos claimants."^{XII} These issues required further exploration on remand, as did the engineering of stub claims for voting purposes.^{XIII} In a footnote, the court also rejected the argument that the treatment of stub claims did not violate section 502 even though the debtor itself had no liability for those claims. By this, the court apparently meant that such claims are allowable.

Finally, the court held that the insurers had standing to appeal only the district court's modification to the plan's "super-preemptory" provision, which originally "provided that nothing in the plan would impair the 'insurers' pre-petition rights under subject insurance policies and settlements,"^{XIV} to refer to the rights of insurers, "if any, in respect of any claims (as defined by section 101(5) of the Bankruptcy Code)."^{XV}

The court found that the insurers had standing to challenge that modification, but only that modification^{XVI}: "Affirming the pre-petition contractual obligations of the Objecting Insurers and London Market Insurers does not impair their rights or increase their burdens under the subject insurance policies. We conclude, therefore, the [Insurers] have no appellate standing to challenge the addition of the neutrality provision."^{XVII}

^{VIII} *Id.* at *114–16.

^{IX} *Id.* at *126–27.

^X *Id.* at *129–30.

^{XI} *Id.* at *131–33.

^{XII} *Id.* at *133.

^{XIII} *See id.* at *143–44.

^{XIV} *Id.* at *52–*54.

^{XV} *See id.* at *54.

^{XVI} *Id.* at *58–*59.

^{XVII} *Id.* at *60–*61.