
PRE-PACKAGED ASBESTOS BANKRUPTCIES: A FLAWED SOLUTION

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I. INTRODUCTION

“Pre-packaged” bankruptcies, or “pre-packs,” are the latest thing in the world of litigation relating to asbestos-related bodily injury claims. The use of pre-packs is seen by some as a quick, cheap way out of a fast-rising tide of asbestos claims that are paralyzing both companies and the legal system, because the debtor is able to take advantage of the special “asbestos trust” and “channeling injunction” provisions of the Bankruptcy Code¹ with only a short stay in Chapter 11.²

At its core, a pre-pack is a plan of reorganization that is negotiated and voted on before the company actually files its bankruptcy petition.³ Although the Bankruptcy Code has long contained provisions that have allowed pre-packs to be successfully used in non-asbestos bankruptcies, only recently have they become commonplace in the asbestos context.⁴ Like many things in the field of asbestos litigation, however, what works seamlessly elsewhere encounters obstacles when transported to the asbestos area. In particular, asbestos bankruptcy pre-packs have not yet delivered on their promise of a quick, painless, and ultimately successful tour through bankruptcy court.⁵ Instead, the two most recent cases have been plagued by disputes, uncertainty, and so far, a lack of success, and rightly so, in our view, because the pre-packaged asbestos bankruptcies that have been filed to date pervert and distort the Bankruptcy Code and the procedures that enable pre-packs to be successful in other types of bankruptcy cases.

In this article, we begin by reviewing the process followed in

1. See 11 U.S.C. § 524(g) (2000).

2. See 11 U.S.C. §§ 1101.

3. See, e.g., *United Artists Theatre Co. v. Walton*, 315 F.3d 217, 224 n.5 (3d Cir. 2003) (distinguishing pre-packs from “pre-approved” or “pre-negotiated” bankruptcies and conventional bankruptcy cases); see also *In re NRG Energy, Inc.*, 294 B.R. 71, 82 (Bankr. D. Minn. 2003) (citing additional cases and articles on pre-packs generally).

4. Mark D. Plevin, et al., *Where Are They Now? Part Two: A Continuing History of the Companies That Have Sought Bankruptcy Petition Due to Asbestos Claims*, 17 MEALEY'S LITIG. REPORT: ASBESTOS 1, 5 (2002).

5. See *id.*

“conventional” bankruptcy cases and comparing it to the procedures used in pre-packaged cases. We then examine the two most recent pre-packaged asbestos bankruptcy cases, *In re J.T. Thorpe Corp.* and *In re Combustion Engineering, Inc.*, and explore why these cases do not comply with the Bankruptcy Code.⁶

II. HOW DO CONVENTIONAL CHAPTER 11 CASES AND PRE-PACKAGED BANKRUPTCY CASES DIFFER?

A. *The Conventional Chapter 11 Process*

The traditional or conventional Chapter 11 process involves many required steps that can frequently take years to complete. In a conventional Chapter 11 case, a debtor files in order to begin the process of negotiating with its creditors over a plan of reorganization.⁷ The filing of the Chapter 11 petition operates as an automatic stay of all lawsuits against the debtor⁸ and all efforts to collect on any pre-petition obligation of the debtor.⁹ The purpose of the stay is to provide the debtor with breathing room during which plan negotiations can take precedence.¹⁰

Plan negotiations typically are conducted primarily between the debtor and one or more official committees appointed shortly after the filing of debtor's bankruptcy petition, although any party in interest may seek to participate in negotiations.¹¹ The committees are permitted to engage professionals to represent them in court and in the negotiations, and the fees of such professionals are paid by the estate, subject to the approval of the

6. For general background on asbestos bankruptcies, see Mark D. Plevin & Paul W. Kalish, *What's Behind the Recent Wave of Asbestos Bankruptcies?*, 16 MEALEY'S LITIG. REPORT: ASBESTOS 35 (2001).

7. See *id.* at 38–39.

8. 11 U.S.C. § 362(a)(1) (2000) stays “the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the [bankruptcy] case . . .”; § 362(a)(2) stays “the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the [bankruptcy] case . . .”.

9. 11 U.S.C. § 362(a)(3) stays “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate” Section 362(a)(6) stays “any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the [bankruptcy] case” Sections 362(a)(4)–(5) stay any acts to enforce or create liens against the debtor or its property.

10. See H.R. REP. NO. 95-595, at 340 (1977); S. REP. NO. 95-989, at 54–55 (1978) (“The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan . . .”).

11. See 11 U.S.C. § 1102.

bankruptcy court.¹² The debtor has a 120-day period, beginning from the date the petition is filed, during which it has an exclusive right to file a plan, and a 180-day exclusive period to solicit acceptances of the plan.¹³ These exclusivity periods may be, and frequently are, extended,¹⁴ particularly in complex cases.¹⁵

Once the debtor reaches agreement with its major constituencies on a plan that appears to have the necessary support to be confirmed, the plan will be filed with the bankruptcy court.¹⁶ The debtor may not solicit acceptances of the proposed plan, however, until the bankruptcy court, after notice and a hearing, approves a disclosure statement that is designed to provide persons voting on the plan with “adequate information” to make an informed judgment whether to vote in favor of or against the plan.¹⁷ In complex cases generally, and in asbestos bankruptcy cases in particular, disclosure statements are frequently several hundred pages long, containing a detailed description of the debtor’s history, the reasons it filed for bankruptcy, a summary of the plan, and other required elements.

Once the disclosure statement is approved, it is mailed, together with the plan and ballots to be used in accepting or rejecting the plan, to those entitled to vote on the plan.¹⁸ In addition, notice is typically published in national, regional, and/or local newspapers, as appropriate.¹⁹ If it appears,

12. See 11 U.S.C. §§ 1103, 328, 331; FED. R. BANKR. P. 2014, 2016.

13. See 11 U.S.C. § 1121.

14. See 11 U.S.C. § 1121(d).

15. For example, the exclusivity periods are frequently extended in asbestos bankruptcy cases. *See, e.g.*, Order, *In re Global Indus., Inc.*, No. 02-32626 (Bankr. W.D. Pa. June 10, 2003) (ordering a fourth extension of exclusivity) (on file with authors); Order, *In re W.R. Grace & Co.*, No. 01-01139 (Bankr. D. Del. Mar. 3, 2003) (ordering a fourth extension of exclusivity) (on file with authors); Order, *In re USG Corp.*, No. 01-02094 (Bankr. D. Del. Nov. 8, 2002) (ordering a third extension of exclusivity) (on file with authors); *In re Porter-Hayden Co.*, No. 02-05-4152SD (Bankr. D. Md. June 9, 2003) (insurer objection to proposed fourth extension of exclusivity) (on file with authors).

16. See 11 U.S.C. § 1121. If exclusivity has terminated, then any party in interest may file a plan. 11 U.S.C. § 1121(c). Plans can also be filed without any pre-formed consensus.

17. See 11 U.S.C. § 1125(b); FED. R. BANKR. P. 3017. “Adequate information” is defined in 11 U.S.C. § 1125(a)(1).

18. FED. R. BANKR. P. 3017(d). In addition, it is now common for debtors to post the documents on a public Internet web site, where any person can access them. Further, the documents are frequently available through official court web sites, at least for those bankruptcy courts that utilize efilings (such as the District of Delaware and Southern District of Texas bankruptcy courts). In order to obtain a discharge, a debtor must give its known creditors formal written notice of the bankruptcy case, the plan, and the deadline for objections. *See, e.g.*, *In re Trans World Airlines, Inc.*, 96 F.3d 687, 690 (3d Cir. 1996); *In re Maya Constr. Co.*, 78 F.3d 1395, 1399 (9th Cir. 1996); *In re Union Hosp. Ass’n of the Bronx*, 226 B.R. 134, 139 (Bankr. S.D.N.Y. 1998).

19. See, e.g., *In re Eagle-Picher Indus., Inc.*, 278 B.R. 437, 453 (Bankr. S.D. Ohio 2002) (citing *Chemetron Corp. v. Jones*, 72 F.3d 341, 346 (3d Cir. 1995)); *In re Union Hosp. Ass’n of the Bronx*, 226 B.R. 134, 139 (Bankr. S.D.N.Y. 1998); *In re U.S.H. Corp. of New York*, 223 B.R.

after the votes have been tabulated, that the various classes have voted in favor of the plan,²⁰ the bankruptcy court, after notice, will hold a hearing on whether to confirm the plan. Any party in interest may file an objection to confirmation of a plan.²¹ Whether or not an objection is filed, the bankruptcy court must review the plan to ensure that it meets the statutory requirements for confirmation.²² If it does, the plan will be confirmed.²³

It is not atypical for plans in conventional (*i.e.*, non-pre-packaged) asbestos bankruptcy Chapter 11 cases to not be confirmed until many years after commencement of the bankruptcy case. For example, in one of the earliest asbestos bankruptcy cases, *Johns-Manville Corporation*, the plan was confirmed six years after the bankruptcy case was commenced.²⁴ It took ten years from the commencement of its bankruptcy case for Forty-Eight Insulations, Inc. to confirm its plan of reorganization.²⁵ Some of the more recent conventional asbestos bankruptcy filings still do not have confirmed reorganization plans even though they have been in court for several years. For example, Babcock & Wilcox Company does not have a confirmed plan even though it commenced its bankruptcy case in February 2000.²⁶ Similarly, USG Corporation²⁷ and W.R. Grace²⁸ filed their bankruptcy petitions in 2001, but neither debtor has yet filed a plan of reorganization.

654, 658 (Bankr. S.D.N.Y. 1998).

20. See 11 U.S.C. § 1126(c)–(d) (setting forth rules for determining if a class has accepted the plan). In certain circumstances, a class is conclusively presumed to have accepted or rejected the plan. See 11 U.S.C. § 1126(f) (unimpaired classes are presumed to have accepted the plan, and their votes need not be solicited); 11 U.S.C. § 1126(g) (impaired classes not entitled to any distribution under a plan are deemed to have rejected the plan); 11 U.S.C. § 1128(a); FED. R. BANKR. P. 3020(b)(2).

21. 11 U.S.C. § 1128(b); FED. R. BANKR. P. 3020(b).

22. See, e.g., *In re Szostek*, 886 F.2d 1405, 1414 (3d Cir. 1989) (stating a bankruptcy court has an independent duty to “examine a plan for compliance with the code even though no objections by creditors are made”); *In re Bolton*, 188 B.R. 913, 915 (Bankr. D. Vt. 1995) (stating “[w]e have an independent duty to ensure that a plan satisfies all of the elements of section 1129 before ordering confirmation even though no objections were filed.”).

23. The statutory requirements for confirmation are set forth in 11 U.S.C. § 1129(a). See FED. R. BANKR. P. 3020(b)(2) (permitting the bankruptcy court, in a case where no objections to plan confirmation have been filed, to determine compliance with certain elements of § 1129(a) without hearing evidence).

24. See *In re Johns-Mansville*, 843 F.2d 636, 639–41 (2d Cir. 1988) (stating that the bankruptcy petition was filed in 1982 and a plan was confirmed in 1988).

25. See *Matter of Forty-Eight Insulations, Inc.*, 115 F.3d 1294, 1297 (7th Cir. 1997).

26. *In re Babcock & Wilcox Co.*, 274 B.R. 230, 233 (Bankr. E.D. La. 2002).

27. *In re USG Corp.*, 290 B.R. 223 (Bankr. D. Del. 2003).

28. *In re W.R. Grace & Co.*, 285 B.R. 148, 153 (Bankr. D. Del. 2002).

B. *The Chapter 11 Process in “Pre-Packaged” Cases*

Pre-packaged asbestos bankruptcy cases, in contrast, proceed on a more expedited schedule. One defining difference between conventional cases and pre-packs is that in a pre-packaged case, plan negotiations, distribution of disclosure statements, and voting all take place before the bankruptcy case is filed. As a result, a debtor in a pre-packaged bankruptcy typically files along with its petition, a plan and disclosure statement.²⁹ The court will then frequently hold a single hearing to determine the adequacy of the pre-petition disclosure and whether the plan should be confirmed. Depending on the court’s calendar, it is theoretically possible for a pre-packaged bankruptcy to go from petition to confirmation in as few as 30 to 45 days.³⁰ A faster trip through bankruptcy court means both lower bankruptcy-case professional fees and less business disruption.

There are, of course, risks to a debtor who chooses to proceed via a pre-packaged bankruptcy rather than a conventional one. If, for example, the bankruptcy court finds the disclosure statement inadequate in some respect, the debtor will have to amend and redistribute the disclosure statement, and re-solicit plan acceptances, resulting in potentially lengthy delays in confirmation.³¹ A second concern is that it is more likely than in a conventional case that all persons asserting claims were not properly solicited and given an opportunity to vote.³² In conventional Chapter 11 cases, the debtor typically gives notice of the bankruptcy case, and of the right to vote, by publication, in addition to direct notice to known claimants.³³ By contrast, in a pre-packaged bankruptcy, it is possible for the

29. 11 U.S.C. § 1121(a) (2000) specifically authorizes a debtor to “file a plan with a petition commencing a voluntary case” See 11 U.S.C. § 1126(b) (providing that a person who accepted or rejected a plan before the commencement of a case is deemed to have accepted or rejected the plan for bankruptcy purposes, if the solicitation of such acceptances or rejections met the disclosure requirements of 11 U.S.C. § 1125 or any applicable non-bankruptcy law governing disclosure); FED. R. BANKR. P. 3018(b) (providing certain rules for treatment of acceptances or rejections obtained pre-petition).

30. See, e.g., FED. R. BANKR. P. 2002(b); see also Spring Creek Gen. Improvement Dist. Local Rule 1020 (Bankr. S.D. Tex.).

31. See, e.g., *In re City of Colorado Springs*, 177 B.R. 684, 691 (Bankr. D. Colo. 1995) (stating a proponent of a prepackaged plan takes a substantial risk that, at the confirmation stage of a case, the court may determine that the proposed disclosure statement or process of solicitation are inadequate such that “any shortcoming . . . would require going back to the drawing board for a bankruptcy regulated disclosure statement hearing with notice, and the usual bankruptcy process toward a hearing on confirmation.”) (quoting *In re Southland Corp.*, 124 B.R. 211, 225 (Bankr. N.D. Tex. 1991)).

32. All persons whose claims are “impaired” by the plan are entitled to vote on the plan. See 11 U.S.C. §§ 1126(a), (c), (f), (g), 1129(a)(7) (2000). “Impairment” is defined in 11 U.S.C. § 1124 (2000).

33. 11 U.S.C. § 342; *In re Argonaut Fin. Servs., Inc.*, 164 B.R. 107, 111–12 (Bankr. N.D. Cal. 1994).

debtor to overlook giving notice to potential claimants.³⁴ If the debtor did not solicit claimants who have the right to vote on the pre-packaged plan, the debtor must give them an opportunity to vote; otherwise the claimants may be able to successfully challenge the plan on appeal.³⁵

A third concern is that parties in interest who were not included in the pre-petition plan negotiations, and whose interests are therefore not reflected in the proposed plan, may delay or derail confirmation by objecting to the plan, thereby depriving the debtor of some or all of the anticipated benefits of the pre-pack. For example, two recent asbestos pre-packs failed to include the insurers whose policy proceeds were to fund the “asbestos trust” under the plan. The resulting litigation has, to date, deprived the debtors in those cases of the benefits they sought in their pre-packaged cases.

III. RECENT PRE-PACKAGED ASBESTOS BANKRUPTCIES

Recently, three companies who have been defendants in asbestos bodily injury lawsuits filed pre-packaged plans of reorganization. First, on April 8, 2002, Shook & Fletcher Insulation Co. (“Shook & Fletcher”) filed a pre-packaged plan in the Bankruptcy Court for the Northern District of Alabama.³⁶ Next, on October 1, 2002, J.T. Thorpe Company filed its pre-packaged plan of reorganization in the Bankruptcy Court for the Southern District of Texas.³⁷ The most recent asbestos pre-pack was Combustion Engineering, Inc.’s pre-packaged plan of reorganization filed on February

34. Cf. *In re City of Colorado Springs Spring Creek Gen. Improvement Dist.*, 177 B.R. 684, 691 (Bankr. D. Colo. 1995) (stating that “[w]ith a prepackaged bankruptcy . . . the Court must review the . . . completed solicitation process to verify that substantially all of the creditors received adequate notice of the plan and disclosure statement and had an opportunity to vote upon and object to the plan”).

35. Fed. R. Bankr. P. 3018(b) (pre-petition votes accepting or rejecting a plan “shall not be deemed to have accepted or rejected the plan if the court finds after notice and hearing that the plan was not transmitted to substantially all creditors”); *In re Pioneer Finance Corp.*, 246 B.R. 626, 633 (“a prepetition solicitation process must be scrutinized to ensure that substantially all creditors who are affected by the plan receive notice,” and, “where there is no evidence that the solicitation had been sent” to substantially all affected creditors, confirmation of the plan must be denied).

36. See Voluntary Petition, *In re Shook & Fletcher Insulation Co.*, No. 02-02771-BGC-11 (Bankr. N.D. Alabama April 8, 2002). While Shook & Fletcher was the first of the recent spate of pre-packaged asbestos bankruptcy cases, it was not the first such pre-pack; there is at least one earlier one, that of Fuller-Austin. See *In re Fuller-Austin Insulation Co.*, No. 98-2038-JJF, 1998 U.S. Dist. LEXIS 812388, at *1 (D. Del. Nov. 10, 1998) (stating that Fuller-Austin’s plan of reorganization was filed on September 4, 1998).

37. Voluntary Petition, *In re JT Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Oct. 1, 2002); Chapter 11 Plan of Reorganization, *In re JT Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Oct. 1, 2002).

17, 2003 in the Bankruptcy Court for the District of Delaware.³⁸

In announcing their pre-packs, each of these debtors sounded a similar theme. Shook & Fletcher said it decided to take the pre-pack route after attorneys for asbestos claimants began insisting “that any settlement arrangement be structured to try to avoid [delays in payment and extensive litigation costs] by providing security for a portion of the payments to present claimants, and by entering into and implementing agreements pre-petition, including establishing a pre-petition trust mechanism.”³⁹ Shook & Fletcher stated its belief that a pre-pack was the “most efficient and fair way to accomplish” its goals of “provid[ing] fair compensation for individuals who were truly injured as a result of asbestos products” and “preserv[ing] Shook’s business and goodwill.”⁴⁰

J.T. Thorpe Company said it filed its pre-packaged plan of reorganization in order to “[settle] asbestos claims against the company in conjunction with a prepackaged plan of reorganization, relying on section 524(g) of the Bankruptcy Code to develop a process to permit Asbestos Claimants to resolve their claims against J.T. Thorpe without the costs of protracted litigation.”⁴¹ In a statement similar to that of Shook & Fletcher, J.T. Thorpe stated its belief that a pre-pack was “[t]he most efficient and fair route to accomplish” its twin goals of “provid[ing] fair compensation for individuals who were truly injured as a result of asbestos products” and “preserv[ing] Debtor’s business and goodwill. . . .”⁴²

Combustion Engineering, Inc. stated that it chose a pre-pack because of its conviction that a conventional “Chapter 11 would . . . have resulted in a protracted and expensive process that would both delay and reduce payments to current and future claimants, and no funding from [its parent company] ABB could be assured.”⁴³ Combustion Engineering “ultimately concluded that pursuing a consensual reorganization provided the best chance to maximize recovery for current and future claimants, minimize litigation and transaction costs, expedite payments to deserving claimants

38. Voluntary Petition, *In re* Combustion Eng’g, Inc., No. 03-10495 (Bankr. D. Del. Feb. 17, 2003); Chapter 11 Plan of Reorganization, *In re* Combustion Eng’g, Inc., No. 03-10495 (Bankr. D. Del. Feb. 17, 2003).

39. Declaration of Wayne W. Killion, Jr. In Support of Voluntary Petition and First Day Motions ¶ 12, *In re* Shook & Fletcher Insulation Co., No. 02-02771 (Bankr. N.D. Ala. Apr. 3, 2002) (on file with authors).

40. *Id.* ¶ 11.

41. Declaration of Gerald W. Scott ¶ 14, *In re* J.T. Thorpe Co., No. 02-41487-45-11 (Bankr. S.D. Tex. Oct. 1, 2002) (on file with authors).

42. *Id.* ¶ 13.

43. Affidavit of John Brett ¶ 46, *In re* Combustion Eng’g, Inc., No. 03-10495 (JKF) (Bankr. D. Del. Feb. 18, 2003) (on file with authors).

and enhance the value of CE's estate.”⁴⁴

At least two additional pre-packaged asbestos bankruptcy cases have been publicly announced but, as of this writing, not yet filed. In January 2003, Halliburton Company announced a “global settlement” with asbestos claimants that would involve certain Halliburton subsidiaries (including DII Industries, LLC, formerly Dresser Industries, and Kellogg, Brown & Root) filing a pre-packaged plan of reorganization.⁴⁵ While only certain subsidiaries of Halliburton would actually file bankruptcy petitions, Halliburton plans to use the Section 524(g) injunctions to “resolve all liability of Halliburton and its subsidiaries for all present and future personal injury asbestos claims. . . .”⁴⁶ Halliburton stated its view that a pre-pack was the “only means to access 524(g) injunctive relief;” that “no customers, creditors, vendors, or employees” would be impaired by the plan; and that a pre-pack offered “reduced time in Chapter 11, limited operational constraints, and reduced outcome risk since [the] deal is pre-negotiated.”⁴⁷

Also in January 2003, floor tile manufacturer Congoleum Corporation announced that it is planning to make a pre-packaged Chapter 11 filing in order to address its asbestos-related liabilities.⁴⁸ Congoleum expects:

[T]he plan of reorganization would provide for an assignment of applicable Congoleum insurance to a trust that would fund both the settlement of pending asbestos claims as well as future asbestos claims, and that the plan would leave Congoleum’s trade creditors unimpaired and protect the company from any future asbestos-related litigation.⁴⁹

“On March 31, 2003, the Company reached an agreement in principle with attorneys representing more than 75% of the known present claimants with asbestos claims pending against Congoleum,” and on April 10, 2003, Congoleum entered into a formal settlement agreement with these asbestos claimants.⁵⁰ Congoleum has also entered into agreements establishing a pre-

44. *Id.* ¶ 47.

45. See Halliburton, *Agreement Summary and Settlement Progress Excerpted from the June 30, 2003 Form 10-Q, Note 11*, available at <http://www.halliburton.com/ir/agreesum.jsp> (last visited Aug. 10, 2003) (on file with South Texas Law Review).

46. *Id.*

47. Halliburton Company Analyst Meeting Presentation (Jan. 13, 2003) (on file with authors).

48. Press Release, Congoleum Corporation, Congoleum Corporation Seeks to Resolve Asbestos Related Claims (Jan. 17, 2003), available at http://litigationdatasource.com/asbestos_litigation_congoleum_seeks.txt (last visited May 30, 2003) (on file with South Texas Law Review).

49. *Id.*

50. *Congoleum Corporation 2002 Form 10-K Report*, available at <http://www.sec.gov/Archives/edgar/data/23341/000117152003000085/d1161.txt> (last visited (Oct. 2, 2003)).

petition trust to distribute funds in accordance with the terms of its settlement agreement with the claimants, and has granted that trust a security interest in its rights under applicable insurance coverage and payments from insurers for asbestos claims.⁵¹

Procedures used in an asbestos bankruptcy are best illustrated by example. Below, we describe the events of the two most recent asbestos pre-packs, *J.T. Thorpe* and *Combustion Engineering*.

A. *J.T. Thorpe*

J.T. Thorpe Company, a small business engaged in the sale, installation, maintenance, repair, removal, and handling of refractory and acid masonry linings and related products,⁵² filed its pre-packaged plan of reorganization on October 1, 2002, and it rocketed to a confirmation hearing barely 10 weeks later. The presiding judges announced at the end of the confirmation hearing on December 18, 2002, that the plan would be confirmed.⁵³ In that sense, the pre-pack was a success. The plan still has not gone into effect, however, because the confirmation order was later stayed pending appeal by the U.S. Court of Appeals for the Fifth Circuit.⁵⁴ The stay remains in effect while the Fifth Circuit considers an appeal by two of J.T. Thorpe's insurers, who had been denied the right to participate at the confirmation hearing.⁵⁵

In late 2001, J.T. Thorpe Company commenced direct negotiations with certain plaintiffs' lawyers concerning a possible "pre-packaged" Chapter 11 bankruptcy filing. At the time, J.T. Thorpe had resolved some 40,000 asbestos claims and was subject to approximately 84,000 unresolved

51. *Id.*

52. Disclosure Statement, at 8, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Aug. 13, 2002) (on file with authors).

53. See Plan Confirmation Hearing, at 196:10–24, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 18, 2002) (on file with authors). The bankruptcy court did not enter the confirmation order, however, until late January 2003. See Order Confirming J.T. Thorpe Company's Plan of Reorganization, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Jan. 17, 2003) (on file with authors). A companion order by the district court (required by 11 U.S.C. § 524(g) for the "channeling injunction" under the plan to have any effect) was entered January 29, 2003, and amended the next day. See Amended Order, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Jan. 30, 2003) (on file with authors). In *J.T. Thorpe*, the bankruptcy judge and district judge jointly presided at the confirmation hearing.

54. See Order Deferring Action on Petition for Writ of Mandamus and Granting Emergency Request for Interim Stay Pending Further Orders of the Court, *In re Am. Motorists Ins. Co.*, No. 03-20112 (5th Cir. Jan. 31, 2003); Order Consolidating Case 03-20135 with 03-20112 and Granting Appellants' Application for a Stay Pending Appeal, *Am. Motorists Ins. Co. v. JT Thorpe Co.*, No. 03-20135 (5th Cir. Feb. 18, 2003).

55. Oral argument of the insurers' appeal took place on May 6, 2003.

claims.⁵⁶ J.T. Thorpe officials hoped that, pursuant to Section 524(g) of the Bankruptcy Code, the company and its affiliates (including its parent company, Thorpe Corporation) could obtain permanent protection from all past, present, and future asbestos liability. Company officials were concerned, however, that a prolonged Chapter 11 case could have detrimental effects on the company and its business.⁵⁷ Accordingly, J.T. Thorpe commenced negotiations with certain lawyers for asbestos claimants, with an eye toward a pre-packaged Chapter 11 filing.

The negotiations led to a two-part structure that has now become commonplace in pre-packaged asbestos bankruptcies. The first part involved the establishment, on June 11, 2002, of a pre-petition trust (known in the *J.T. Thorpe* case as the “Collateral Trust”), that was designed to pay existing asbestos claims, according to schedules negotiated by claimants’ attorneys. Each such attorney separately negotiated the schedule applicable to his or her clients, such that a claimant represented by Attorney A might be entitled to significantly more money than a claimant represented by Attorney B who had the same asbestos-related disease or exposure. Claimants were required to execute “adoption agreements” signifying their desire to qualify for payments by the Collateral Trust, according to the specific schedule negotiated by their particular attorney. As a condition of being paid by the Collateral Trust, each claimant executing an adoption agreement was required to agree to a 120-day litigation moratorium. The adopting claimants agreed that they would not, during the moratorium, pursue any lawsuit or other legal process with respect to any asbestos personal injury claims against J.T. Thorpe or any parent, subsidiary, or affiliate of J.T. Thorpe. J.T. Thorpe, in turn, agreed to toll all time-related defenses to the claims of the adopting claimants.⁵⁸

The Collateral Trust was funded with insurance proceeds received directly from one of J.T. Thorpe’s insurers with whom J.T. Thorpe had settled. In addition, J.T. Thorpe also irrevocably conveyed to the Collateral Trust a security interest in all of J.T. Thorpe’s rights to receive future insurance proceeds on account of asbestos bodily injury claims.⁵⁹ By

56. See Plan Confirmation Hearing, at 43:15–18, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 18, 2002) (on file with authors).

57. See Deposition of Richard Nowland, at 345:15–346:19, *In re J.T. Thorpe Co.* (Bankr. S.D. Tex. Nov. 30, 2002) (on file with authors).

58. See Settlement Agreement between J.T. Thorpe Company and Various Asbestos Claimants, Exhibit H to the Disclosure Statement § V, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Aug. 13, 2002) (No. 02-41487-H5-11) (on file with authors).

59. See Security Agreement and Assignment between J.T. Thorpe Company and Dan B. Lain, Trustee, Exhibit I to the Disclosure Statement § II(A), *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Aug. 13, 2002) (on file with authors); Transcript of Hearing, at 29:15–30:23, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 9, 2002) (on file with

design, the bankruptcy case was not filed until more than 90 days after J.T. Thorpe conveyed these assets to the Collateral Trust, so that there was no possibility that J.T. Thorpe's transfers to the Collateral Trust could later be avoided as preferences.⁶⁰

The Collateral Trust paid certain adopting claimants a total of approximately \$5.7 million during the 90 days prior to the commencement of J.T. Thorpe's bankruptcy case.⁶¹ Because these adopting claimants had their claims paid in full by the Collateral Trust pre-petition, they were not creditors in the bankruptcy case.⁶² Other adopting claimants were not paid at all prior to the commencement of the bankruptcy, because their claims were not processed by the Collateral Trust before the bankruptcy case was filed. This latter group included both adopting claimants who had already entered into settlements with J.T. Thorpe before the Collateral Trust was established, and claimants who did not have settlements that predated the establishment of the Collateral Trust. Those with pre-existing settlements were assured of full payment by being given a secured claim in the bankruptcy case equal to 100 percent of their agreed settlement amount.⁶³ Those adopting claimants who did not have already-agreed settlements at the time the Collateral Trust was established, but who agreed to be paid according to the schedules negotiated by their lawyer, were given a secured claim in the bankruptcy case equal to 75 percent of their settlement amount, leaving an unsecured claim for the 25 percent remainder to be asserted in the bankruptcy case.⁶⁴

The second part of the J.T. Thorpe structure involved the establishment of a second trust (known in the *J.T. Thorpe* case as the

authors).

60. See 11 U.S.C. §547(b)(4)(A) (2000) (establishing a 90-day period for avoidance of preferential transfers to non-insiders of the debtor); 11 U.S.C. §101(31)(B) (defining who is an "insider" of a corporate debtor; the definition does not include a pre-petition trust established by the debtor); Transcript of Hearing, at 31:16-32:5, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 9, 2002) (on file with authors).

61. See Transcript of Hearing, at 35:6-9, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 9, 2002) (on file with authors). Overall, the Collateral Trust disbursed approximately \$6 million to persons who had pre-existing settlement agreements with J.T. Thorpe from the day the trust was established on June 10, 2002 through the day J.T. Thorpe filed its bankruptcy petition. See Deposition of Dan Lain, at 71:12-19, *In re J.T. Thorpe Corp.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Nov. 26, 2002) (on file with authors).

62. Transcript of Hearing, at 35:1-5, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 9, 2002) (on file with authors).

63. See Collateral Trust Agreement, Exhibit G to the Disclosure Statement § II(A)(2), *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Aug. 13, 2002) (on file with authors).

64. Id. § II(A)(3); Settlement Agreement between J.T. Thorpe Company and Various Asbestos Claimants, Exhibit H to the Disclosure Statement § II(A), *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Aug. 13, 2002) (on file with authors).

“Successor Trust”) pursuant to Section 524(g) of the Bankruptcy Code.⁶⁵ The Successor Trust was to be funded with a \$2.3 million note from J.T. Thorpe’s parent company, what was left in the Collateral Trust as of the time J.T. Thorpe’s bankruptcy plan of reorganization was confirmed and went into effect, and future insurance proceeds.⁶⁶ This trust was designed to pay not only future claims, but also the unpaid claims (or portion of claims) of adopting claimants and the claims of any existing claimants who did not sign adoption agreements.⁶⁷

In order for a Chapter 11 plan of reorganization to be confirmed, it must be accepted by creditors holding at least two-thirds in amount and one-half in number of the allowed claims held by such class.⁶⁸ In addition, a plan establishing a trust for payment of asbestos claims must be approved by a supermajority of 75% of current asbestos claimants.⁶⁹ Because the J.T. Thorpe plan provided that non-asbestos unsecured creditors would be unimpaired, the only voting class of creditors consisted of persons asserting asbestos bodily injury claims.⁷⁰ Most of the claimants in this class were persons who, pursuant to their “adoption agreements,” held both a non-voting, unimpaired secured claim for 75 percent of the scheduled value of their claim, and an impaired voting stub claim equal to 25 percent of their claim. Because such claimants had an obvious vested interest in seeing the plan confirmed, so that their 75 percent secured claim would be paid in full, it was expected that all such persons would vote the unsecured stub portion of their claim in favor of the plan. This is exactly what happened and when the votes were tallied more than 99 percent of the votes in this class were in favor of the plan.⁷¹

Under the plan, J.T. Thorpe was entitled, after confirmation, to the special “channeling injunction” contemplated under Section 524(g) of the Bankruptcy Code.⁷² So too, were its parent company, its subsidiaries, the

65. See 11 U.S.C. § 524(g)(2)(B)(I); see also 11 U.S.C. § 524(g)(2)(B)(ii)(V) (setting forth certain requirements as to how the trust must operate).

66. See Disclosure Statement § 4.2, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Aug. 13, 2002) (on file with authors); Index and Glossary, Exhibit A to the Disclosure Statement § 137.

67. See Transcript of Hearing, at 36:8–38:18, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 9, 2002) (on file with authors).

68. 11 U.S.C. § 1126(c).

69. 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb).

70. See 11 U.S.C. § 1126(f) (classes of creditors who are not “impaired” are conclusively presumed to have accepted the plan, and their votes therefore need not be solicited.); see also Plan of Reorganization §§ 3.2, 6.1, 6.4, 6.5, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Oct. 1, 2002).

71. See Plan Confirmation Hearing, at 20:22–21:19, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 18, 2002) (on file with authors).

72. See 11 U.S.C. §§ 524(g)(1)(A)–(B), (3), and (4).

members of the Asbestos Claimants Committee, the Legal Representative of Future Claimants, and settling insurance companies.⁷³

After negotiating the plan and the terms of the Collateral Trust with lawyers for asbestos claimants, preparing and soliciting a disclosure statement and ballots, funding the Collateral Trust, and receiving an overwhelmingly positive response from claimants casting ballots on the plan, J.T. Thorpe filed its bankruptcy petition and pre-packaged plan of reorganization on October 1, 2002. That same day, J.T. Thorpe also filed an application for expedited scheduling of a consolidated hearing to approve its pre-petition disclosure statement and confirm its plan. In response, the bankruptcy court issued a scheduling order, which set the combined hearing for December 16, 2002, with plan objections due November 22, 2002.⁷⁴ Although the objection deadline was subsequently extended to December 9, 2002, the Court's original date for the confirmation hearing never changed; the hearing commenced on December 16, 2002, just 76 days after the bankruptcy case was filed. As indicated above, the two judges presiding over the hearing⁷⁵ announced at the close of the hearing on December 18, 2002, that the plan would be confirmed, although orders to that effect were not docketed until a month later.

Several of J.T. Thorpe's insurers filed objections to the plan and sought to participate in the confirmation hearing by presenting arguments

73. See 11 U.S.C. § 524(g)(4)(A)(ii)–(iii). This sets forth a list of what parties, other than the debtor, may be included within the protection of the channeling injunction. This is essentially a statutory exception to the general principle under 11 U.S.C. § 524(e) that non-debtors are not entitled to the benefits of a bankruptcy discharge. See 11 U.S.C. § 524(e) (stating “Except as provided in subsection (a)(3) of this section [concerning community property], discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”). Compare *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002), *In re Continental Airlines*, 203 F.3d 203, 211 (3d Cir. 2000), and *In re A.H. Robins Co.*, 880 F.2d 694, 702 (4th Cir. 1989) (permitting non-debtor releases under certain circumstances), with *In re Lowenschuss*, 67 F.3d 1394, 1401–02 (9th Cir. 1995), *In re Zale Corp.*, 62 F.3d 746 (5th Cir. 1995), and *In re W. Real Estate Fund, Inc.*, 922 F.2d 592, 600–01 (10th Cir. 1990) (not permitting non-debtor releases).

74. Scheduling Order Pursuant to Debtor's Application for Expedited Scheduling in Connection with Prepackaged Plan of Reorganization Pursuant to S.D. Tex. Local Rule 1020, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Oct. 2, 2002) (on file with authors).

75. The Bankruptcy Code provides that an asbestos channeling injunction, to be effective, must be “issued or affirmed by the district court that has jurisdiction over the reorganization case.” 11 U.S.C. § 524(g)(3)(A) (2000). In response to this statutory provision, in *J.T. Thorpe* the district court elected to sit jointly with the bankruptcy court at the confirmation hearing. In other asbestos bankruptcy cases, the confirmation hearings were conducted solely by bankruptcy judges, who then issued orders and/or reports and recommendations to their respective district courts so those courts could determine whether to issue a channeling injunction. See, e.g., *In re Asbestos Claims Mgt. Corp.*, 294 B.R. 663, 665 (Bankr. N.D. Tex. 2003); *In re Combustion Eng'g, Inc.*, 292 B.R. 515, 517 (Bankr. D. Del. 2003). See generally 28 U.S.C. §157 (2002) (providing rules for division of responsibility between bankruptcy judges and district judges in bankruptcy cases).

and evidence.⁷⁶ Debtor objected that these insurers did not have standing and the bankruptcy and district judges agreed.⁷⁷ Following confirmation of the plan, certain of these insurers sought and obtained, from the U.S. Court of Appeals for the Fifth Circuit, a stay of the confirmation order pending their appeal.⁷⁸ The appeal was briefed on an expedited basis and was orally argued on May 6, 2003. At a minimum, therefore, the insurers' appeal has delayed the effective date of the J.T. Thorpe plan by at least eleven months, from the date the confirmation order was entered; if the Fifth Circuit sustains the appeal and remands for a new confirmation hearing, the delay may be considerably longer, and it is possible the plan will not be confirmed the second time.

B. Combustion Engineering

On February 17, 2003 Combustion Engineering ("CE"), a now mostly-defunct former manufacturer of asbestos-lined boilers, filed its Chapter 11 petition, its pre-packaged plan of reorganization, and the disclosure statement related thereto in the Bankruptcy Court for the District of Delaware.⁷⁹ In typical pre-pack fashion, CE asked the bankruptcy court to commence its confirmation hearing less than two months later. After a number of parties in interest objected, the confirmation hearing eventually was deferred and ultimately commenced on April 24, 2003, slightly more than two months after the bankruptcy case commenced. The hearing consumed six court days over a four-week period, ending June 3, 2003. On June 23, 2003, the bankruptcy court issued an order confirming the disclosure statement but withholding plan confirmation pending the submission of additional materials by CE,⁸⁰ followed on July 10, 2003 by a

76. Several of the insurers who originally objected later entered into a stipulation pursuant to which they withdrew their objections. *See Stipulation and Order*, at ¶ 14, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Dec. 17, 2002) (on file with authors).

77. *See Order on Debtor's Omnibus Objection to Insurers' Standing to Object to Solicitation Procedures, Disclosure Statement and Plan of Reorganization*, *In re J.T. Thorpe Co.*, No. 02-41487-H5-11 (Bankr. S.D. Tex. Jan. 17, 2003) (on file with authors).

78. *See supra* note 54.

79. *In re Combustion Eng'g, Inc.*, 292 B.R. 515, 517 (Bankr. D. Del. 2003); Disclosure Statement, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Jan. 19, 2003) (No. 03-10495 (JKF)) (on file with authors).

80. Order Approving the Disclosure Statement But Recommending Withholding of Confirmation of the Plan of Reorganization For Combustion Engineering For Ten Days, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. June 23, 2003) (No. 03-10495 (JKF)) (on file with authors). This order was accompanied by a document titled Findings of Fact and Conclusions of Law Regarding Core Matters and Proposed Findings of Fact, Conclusions of Law, and Recommendations to the District Court with Respect to Non-Core Matters, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. June 23, 2003) (No. 03-10495 (JKF)) (on file with authors). The two orders are reported together as *In re Combustion Eng'g, Inc.*, 295 B.R. 459 (Bankr. D. Del. 2003).

supplemental order making additional findings and recommending confirmation of the plan.⁸¹ On August 8, 2003, the district court overseeing the bankruptcy proceedings issued an order accepting the bankruptcy court's recommendation and confirming the plan.⁸² It is clear, however, that the district court's confirmation order will not be the last word, as several parties appealed the confirmation to the U.S. Court of Appeals for the Third Circuit, which issued an order granting the parties' stipulation and joint motion for expedition and setting a briefing schedule pursuant to a "standstill agreement" that was filed under seal.⁸³ Oral argument of the appeals is scheduled for December 16, 2003.

Like J.T. Thorpe's bankruptcy case, CE's Chapter 11 filing followed at least four months of pre-petition negotiations with counsel for asbestos claimants. On October 21, 2002, CE's ultimate parent company, ABB Ltd., issued a press release stating that it was "considering various options for resolving [CE's] asbestos liability, including the possible reorganization of CE under Chapter 11 of the U.S. Bankruptcy Code."⁸⁴ Negotiations followed over the next few days in Zurich, Switzerland, between officials of ABB and CE, on the one hand, and a prominent asbestos plaintiffs' attorney, Joseph Rice, on the other hand. The participants signed a non-binding memorandum of understanding on October 23, 2002 setting forth the basic terms of a settlement that would eventually lead to the filing of a pre-packaged bankruptcy.⁸⁵

Final agreement on the settlement of existing claims through use of a pre-petition trust, similar to the "Collateral Trust" utilized in *J.T. Thorpe*, was reached on November 14, 2002.⁸⁶ On November 27, 2002, Mr. Rice prepared letters to his clients and other lawyers for asbestos claimants outlining the terms of a deal that was being extended to "all asbestos victims who had a lawsuit filed against CE as of November 14, 2002 or had submitted their claim to CE for settlement consideration, prior to November

81. Supplemental and Amendatory Order Making Additional Findings and Recommending Confirmation of Plan of Reorganization, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 10, 2003) (No. 03-10495 (JKF)) (on file with authors).

82. See Confirmation Order, *In re Combustion Eng'g, Inc.* (D. Del. Aug. 8, 2003) (Bankr. No. 03-10495 (JKF)) (on file with authors).

83. Order Accepting Standstill Agreement and Expediting Briefing Schedule, *In re Combustion Eng'g, Inc.* Nos. 03-3392, et al. (3d Cir. Aug. 19, 2003) (on file with authors).

84. Press Release, ABB, ABB Considers Options for Combustion Engineering Asbestos Liability (October 21, 2002) available at <http://www.abb.com/Global/SEITP/seitp202.nsf/viewUNID/C1256C290031524BC1256C590053CFF4?Open>. . . (last visited Oct. 10, 2003).

85. See Transcript of Proceedings, at 51:4–16, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

86. See *id.* at 63:3–7, 345:12–15.

15, 2002.”⁸⁷ Accompanying the letter to Mr. Rice’s clients was a General Power of Attorney, to be executed by the clients, that authorized Mr. Rice “to vote on any questions that may be lawfully submitted to creditors of Combustion Engineering, Inc. in any Chapter 11 filed on behalf of the Debtor” and to “vote . . . for any Plan of Reorganization of the Debtor.”⁸⁸ At the same time, Mr. Rice prepared a letter to counsel for other asbestos claimants, inviting their clients to participate in the CE settlement. As part of the proposed agreement to participate, the other claimants’ counsel agreed to associate Mr. Rice (if they had not already done so) as co-counsel to their claims and to pay Mr. Rice a “fair fee” for doing so.

Mr. Rice did not purport to negotiate the terms of a bankruptcy plan.⁸⁹ That job was left to a “Future Claimants’ Representative” to be appointed by CE.⁹⁰ Subsequently, CE asked a prominent lawyer named David Austern, the general counsel of the trust established in the landmark *Johns-Manville* bankruptcy case, to serve in that role. In January, 2003, ABB and CE announced that they had reached an “agreement in principle on a pre-pack asbestos bankruptcy plan for CE” with both Mr. Austern and “attorneys who ABB and CE expect to act on behalf of a sufficient number of current claimants to approve the plan.”⁹¹ ABB and CE stated that they

87. See *id.* at 81:12–21 (quoting Letter from Joseph Rice, Transcript of Proceedings, at Exhibit 20, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors)).

88. See *id.* at 83:19–84:1.

89. See *id.* at 164:13–19.

90. The requirement of a “future claimants’ representative” flows from 11 U.S.C. § 524(g)(4)(B)(i) (2000), which makes the appointment of such a person a condition for issuance of a channeling injunction. The concept arises from the fact that Section 524(g) is designed to address the “demands” of persons who were exposed to asbestos pre-petition but whose claims had not manifested as of the time of confirmation of the plan. A demand is defined as:

“[A] demand for payment, present or future, that (A) was not a claim during the proceedings leading to the confirmation of a plan of reorganization, (B) arises out of the same or similar conduct or events that gave rise to the claims addressed by the injunction issued under paragraph (1), and (C) pursuant to the plan, is to be paid by a trust described in paragraph (2)(B)(i).”

11 U.S.C. § 524(g)(5). See also 11 U.S.C. § 524(g)(2)(B)(i)(IV) (an asbestos trust established in conjunction with issuance of a channeling injunction must “use its assets or income to pay claims and demands”). Since such persons, by definition, cannot represent themselves in the bankruptcy case, the court is to appoint a future claimants’ representative to negotiate on their behalf and to represent their interests. A future claimants’ representative is necessary because “future claimants . . . clearly have a practical stake in the outcome of the [bankruptcy] proceedings” and because the interests of the future claimants could be adversely affected.” See *In re Amatex Corp.*, 755 F.2d 1034, 1041–43 (3d Cir. 1985). A future claimants’ representative gives “putative asbestos disease victims . . . some voice regarding the ultimate fate of [the] Debtors which they currently do not possess.” *In re UNR Indus., Inc.*, 46 B.R. 671, 676 (Bankr. N.D. Ill. 1985).

91. See Press Release, ABB, ABB and Combustion Engineering Reach Asbestos Agreement (January 17, 2003) available at <http://www.abb.com/global/abbzh/abbzh251.nsfOpenDatabase&db=/GLOBAL/ABBZH/ABBZH250.NSF&v=553E&e=us&c=C6EE8AA4843F85D8C1256BA>

expected to send the plan out for vote in mid-January 2003.⁹²

Pursuant to its agreement with Mr. Rice, on or about November 22, 2002, CE established a trust, called the “CE Settlement Trust,” which was funded with approximately one-half of CE’s assets plus a sizeable note from ABB.⁹³ In all, approximately \$500 million was irrevocably transferred to the trust, which immediately began to pay the claims of certain current asbestos claimants.⁹⁴

The “master settlement agreement” pursuant to which the CE Settlement Trust was established created three classes of claims, each of which had different terms for payment. Certain asbestos claimants were placed in Payment Category 1, which consisted of “CE Actions which are fully settled . . . as of November 14, 2002” and as to which payment was overdue as of November 14, 2002.⁹⁵ These claimants were to be paid 95 percent of their agreed settlement amounts by the trust, with a “stub” claim equal to 5 percent of their settlement remaining as a claim to be asserted in the bankruptcy case.⁹⁶ Payment Category 2 consisted of claims by persons who were eligible to accept settlement terms negotiated by their counsel as part of “inventory” settlements, but who had not yet signed settlement agreements.⁹⁷ These claimants were to be paid up to 85 percent of the settlement amount they were eligible for under their lawyers’ “inventory” settlements, with a “stub” claim of 15 percent remaining to be asserted in the bankruptcy case.⁹⁸ Finally, Payment Category 3 consisted of claims which had been asserted by November 14, 2002, which did not meet the requirements to be treated as a Payment Category 1 or 2 claim.⁹⁹ These claimants were to be paid up to 75 percent of the amounts they were entitled to receive under schedules negotiated by their counsel as part of the pre-pack negotiation process, with a stub claim of 25 percent remaining to be

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92. *Id.*

93. See Transcript of Proceedings, at 69:7–11, 69:16–22, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

94. See Transcript of Proceedings, at 64:3–4, 90:15–91:8, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 2, 2003) (No. 03-10495 (JKF)) (on file with authors).

95. CE Settlement Trust Agreement § 4.2(a), *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Nov. 22, 2002) (No. 03-10495 (JKF)) (on file with authors).

96. See Transcript of Proceedings, at 70:8–71:7, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

97. CE Settlement Trust Agreement § 4.2(b), *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Nov. 22, 2002) (No. 03-10495 (JKF)) (on file with authors).

98. See Transcript of Proceedings, at 70:8–71:18, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

99. See Transcript of Proceedings, at 72:23–73:4, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

asserted in the bankruptcy case.¹⁰⁰

Following the method used by J.T. Thorpe, the CE plan of reorganization contemplated the establishment of a second trust upon the plan's effective date, known as the "Asbestos PI Trust." The Asbestos PI Trust is to assume all asbestos claims against Reorganized CE and its non-debtor affiliates subject to the Section 524(g) channeling injunction. Under the plan, the Asbestos PI Trust is to be funded with all of CE's cash, all of the rights of CE and its affiliates to insurance for asbestos bodily injury claims, and any undistributed assets remaining from the CE Settlement Trust.¹⁰¹

CE's disclosure statement and plan, together with ballots to be used to accept or reject the plan, were distributed to asbestos claimants beginning on January 19, 2003.¹⁰² The voting period was scheduled to end on February 19, 2003. Although CE, like J.T. Thorpe, intended to delay commencing its bankruptcy case until after the 90-day preference period applicable to the transfers to the pre-petition trust had run, CE ended up filing its bankruptcy petition just before expiration of the preference period, amid threats by opponents of the plan to commence an involuntary Chapter 7 case if CE did not file its Chapter 11 case before the end of the preference period.¹⁰³

While ABB, CE, and the settling claimants' counsel suggested that CE's pre-pack enjoyed virtually unanimous support, the threatened involuntary bankruptcy filing demonstrated that not all of the persons asserting asbestos claims against CE supported the plan. These claimants, including persons suffering from mesothelioma, a cancer caused only by exposure to asbestos, had three primary objections to the plan. First, they

100. See CE Settlement Trust Agreement § 5.1(c), *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Nov. 22, 2002) (No. 03-10495 (JKF)) (on file with authors). Category 3 claimants were to receive the first 37.5 percent of their settlement amount on the later of January 16, 2003 and 5 days following the Settlement Trust's receipt of their qualification, and an amount not-to-exceed 37.5 percent of the claimants' pro-rata share of the remaining balance of the CE Settlement Trust assets after payment of Category 1 and Category 2 amounts. *Id.* The parties later agreed to create a Category 4, which was to be paid less than 37.5 percent. See *In re Combustion Eng'g, Inc.*, 295 B.R. 459, 466–67 (Bankr. D. Del. 2003).

101. See Disclosure Statement and Solicitation of Votes With Respect to the Pre-Packaged Plan of Reorganization of Combustion Engineering, Inc. at § 8.3, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Feb. 17, 2003) (No. 03-10495 (JKF)) (on file with authors).

102. Like J.T. Thorpe's plan, the CE plan treated all other claims (including non-asbestos general unsecured claims) as unimpaired, so only asbestos claimants were permitted to vote on the plan. See *id.* at 6.4.

103. See *In re Combustion Eng'g, Inc.*, 289 B.R. 515, 517 (Bankr. D. Del. 2003); Informational Statement of the Pre-Petition Committee of Select Asbestos Claimants, § C, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Feb. 28, 2003) (No. 03-10495 (JKF)) (on file with authors); Transcript of Proceedings, at 242:2–15, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. April 24, 2003) (No. 03-10495 (JKF)) (on file with authors).

believed the plan paid too much to claimants suffering from less serious conditions or who were unimpaired, thus depleting the amount of money available for cancer claimants. Second, these claimants alleged that certain law firms had been tipped off in advance of the November 14, 2002 deadline for assertion of claims eligible for payment by the pre-petition CE Settlement Trust, which paid claimants more generously than the post-petition trust was likely to be able to do. Finally, these claimants alleged that the overall plan discriminated against future claimants and existing claimants who did not qualify for payment by the CE Settlement Trust, since such claimants would likely be paid less than claimants eligible to be paid by the CE Settlement Trust.¹⁰⁴

Many of CE's insurers also objected to the plan. One group of insurers had settled their insurance coverage disputes with CE long before the pre-pack was filed. These insurers asserted rights, under their settlement agreements with CE, to indemnification of certain liabilities. These insurers had several complaints about the plan. First, they complained that they were not permitted to vote on the plan even though it impaired their contractual indemnity rights. Second, they complained that the plan, as drafted, sought a judicial declaration concerning the scope and coverage of the indemnities, but without the required adversary proceeding lawsuit having been filed. Third, they complained that they were purposefully excluded from the pre-petition negotiation process even though they were creditors of the estate who should have been invited to the negotiating table. Finally, a subset of these insurers whose settlement agreements CE proposed to assume as "executory contracts"¹⁰⁵ objected that their rights under such "executory contracts" were not being protected in the manner required by statute.¹⁰⁶

104. See Complaint for Injunctive Relief to Prevent Disbursements from the CE Settlement Trust ¶ 46, Pre-Petition Committee of Select Asbestos Claimants and Victor Trinchese v. Combustion Eng'g, Inc. (*In re Combustion Eng'g, Inc.*), (Bankr. D. Del. Feb. 27, 2003) (No. 03-50995) (on file with authors); Objections of Certain Cancer Claimants to Debtor's Motion to Approve Disclosure Statement, Solicitation Procedures and Pre-Packaged Plan of Reorganization ¶¶ 89–95, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Mar. 26, 2003) (No. 03-10495 (JKF)) (on file with authors). These objectors subsequently submitted to the district court overseeing the *Combustion Engineering* case a lengthy draft opinion setting out all of their arguments why the CE plan should not be confirmed. See Proposed Opinion Submitted By Certain Cancer Claimants, *In re Combustion Engineering, Inc.* (Bankr. D. Del. July 24, 2003) (No. 03-10495 (JKF)) (on file with authors).

As of the commencement of the CE bankruptcy case, the CE Settlement Trust had expended \$45 million to pay the settled asbestos claims. The Settlement Trust continued to pay claims even after the CE bankruptcy case was filed.

105. 11 U.S.C. § 365 (2000).

106. See generally Objections of Century Indemnity Company to (i) Confirmation of Debtor's Plan of Reorganization and (ii) Approval of Debtor's Disclosure Statement, 18–21, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Mar. 13, 2003) (No. 03-10495 (JKF)) (on file with authors); Objections of the AIG Member Companies to the Plan of Reorganization Under Chapter

A second group of objecting insurers had not settled with CE prepetition. These insurers objected that the plan sought to induce the bankruptcy court to make certain “findings” about CE’s insurance, and the insurers’ defenses to coverage, that had no basis in fact or law. These insurers generally contended that the settlement CE had negotiated with Mr. Rice and Mr. Austern was not covered under their insurance policies, and that plan “findings” could not lawfully protect CE from the ramifications of its own actions, which served to breach CE’s obligations under the policies. The insurers also objected that confirmation of the plan could not “accelerate” any payment obligations they might eventually have with respect to future claims of persons who were exposed to asbestos prepetition but who had not yet realized they had any injuries.¹⁰⁷

A third group of insurers who had never insured CE, but instead had insured Basic, Inc. and/or Lummus, non-debtor affiliates of CE, objected to the plan on the grounds that it purported to affect their policy obligations. These insurers argued that the bankruptcy court lacked jurisdiction to affect, in any way, the contractual relationship between them and their non-debtor

11 of the United States Bankruptcy Code for Combustion Engineering, Inc. ¶¶ 22–24, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Mar. 13, 2003) (No. 03-10495 (JKF)) (on file with authors); Supplemental Objections to the Plan of Reorganization Under Chapter 11 of the United States Bankruptcy Code for Combustion Engineering, Inc. and Reservation of Rights ¶ 1, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Mar. 26, 2003) (No. 03-10495 (JKF)) (on file with authors); Objection of CNA Insurers to Pre-Petition Date Solicitation Procedures, Approval of Disclosure Statement and Confirmation of Plan of Reorganization, at 41–42, *In re Combustion Eng’g, Inc.* (Bankr. D. Del., Mar. 26, 2003) (No. 03-10495 (JKF)) (on file with authors); Certain Indemnified Insurers’ Proposed Findings of Fact and Conclusions of Law in Opposition to Confirmation, at 27–28, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 21, 2003) (No. 03-10495 (JKF)) (on file with authors).

107. See First State Insurance Company’s Initial Objections to Confirmation of the Proposed Plan of Reorganization, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Mar. 26, 2003) (No. 03-10495 (JKF)) (on file with authors); Objection to the Debtor’s Prepetition Procedures and Disclosure Statement and to Confirmation of the Debtor’s Purported “Prepackaged” Plan of Reorganization (Corrected) [filed by The Travelers Indemnity Company], *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Mar. 26, 2003) (No. 03-10495 (JKF)) (on file with authors); Travelers’ Proposed Findings of Fact and Conclusions of Law, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 21, 2003) (No. 03-10495 (JKF)) (on file with authors); First State’s Proposed Findings of Fact and Conclusions of Law Supporting Denial of Debtor’s Request for Approval of Disclosure Statement and Confirmation of Plan of Reorganization, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 21, 2003) (No. 03-10495 (JKF)) (on file with authors). Policyholders and their allies arguing in favor of acceleration generally cite *UNR Indus., Inc. v. Continental Cas. Co.*, 942 F.2d 1101 (7th Cir. 1991), *cert. denied*, 503 U.S. 971 (1992), in which the court held that the confirmation of a Chapter 11 plan constituted a judgment or settlement for all of the debtor’s asbestos-related liabilities. Insurers generally argue that *UNR* was incorrectly decided, citing to the bankruptcy and district court opinions in *In re Amatek Corp.*, 97 B.R. 220 (Bankr. E.D. Pa. 2002), *aff’d*, 102 B.R. 411 (E.D. Pa. 1989), *aff’d without op.*, 908 F.2d 961 (3d Cir. 1990). A discussion of these cases is beyond the scope of this article.

policyholders.¹⁰⁸

One of CE's officials testified during the confirmation hearing that the insurers were not included in the pre-petition plan negotiations because doing so would have unduly delayed the negotiations.¹⁰⁹ Yet it is clear that CE's failure to secure the assent of its insurers and the dissident claimants has, at a minimum, cost it time, since the onset of the confirmation hearing was delayed at the objectors' request and then, once the hearing started, it was extended by the objectors' presentation of evidence and argument.

On June 23, 2003, the bankruptcy judge presiding over the *Combustion Engineering* bankruptcy issued an order approving the disclosure statement but recommending that confirmation of the plan be withheld.¹¹⁰ She concluded that Basic and Lummus, CE's non-debtor affiliates, could not be included within the Section 524(g) channeling injunction with respect to asbestos liabilities that were not derivative of CE's liabilities. She also determined, however, that Basic and Lummus could receive an injunction protecting them from such liabilities under Section 105 of the Bankruptcy Code¹¹¹ if CE submitted additional evidence establishing that persons asserting asbestos claims against Basic and Lummus which were not derivative of CE asbestos liabilities had been separately solicited to vote on the plan and had overwhelmingly voted to accept the plan, and if CE submitted separate trust distribution procedures for such non-derivative Basic and Lummus asbestos claims.¹¹² If this were done, the bankruptcy judge would recommend confirmation of the plan. On July 10, 2003, the bankruptcy judge issued an order recommending

108. See Objection of Liberty Mutual Insurance Company to Debtor's Plan of Reorganization and Disclosure Statement, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Mar. 28, 2003) (No. 03-10495 (JKF)) (on file with authors); London Market Insurers' Response to Debtor's Confirmation Brief and Objections to Debtor's Plan of Reorganization and Disclosure Statement, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Apr. 22, 2003) (No. 03-10495 (JKF)) (on file with authors); London Market Insurers' Proposed Findings of Fact and Conclusions of Law Related to Basic and Lummus, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. May 21, 2003) (No. 03-10495 (JKF)) (on file with authors).

109. See Transcript of Confirmation Hearing, at 45:7–10, 50:23–51:11, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. May 12, 2003) (No. 03-10495 (JKF)) (on file with authors). On the other hand, CE made a concerted effort to meet with, and satisfy the demands, of asbestos claimants. See *id.* at 52:15–54:2. Transcript of Confirmation Hearing, at 239:22–240:12, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Apr. 24, 2003) (No. 03-10495 (JKF)) (on file with authors); Deposition of David Bernick, at 34:14–15, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Apr. 8, 2003) (No. 03-10495 (JKF)) (ABB's lead counsel testifying that in connection with the pre-pack negotiations, "[o]ur goal was to satisfy the plaintiffs' bar very broadly") (on file with the authors).

110. *In re Combustion Eng'g, Inc.*, 295 B.R. 459, 461 (Bankr. D. Del. 2003).

111. 11 U.S.C. § 105 (2002).

112. *In re Combustion Eng'g, Inc.*, 295 B.R. 459, 485 (Bankr. D. Del. 2003) (citing *In re Dow Corning Corp.*, 208 F.3d 648 (6th Cir. 2002)). See also *id.* at 476–79.

confirmation of the plan because the debtor's supplemental filings regarding Basic and Lummus were deemed sufficient.¹¹³ A flurry of appeals followed,¹¹⁴ including an appeal by the plan proponents.¹¹⁵ The district court ordered expedited briefing and argument of the appeals.¹¹⁶ On July 31, 2003, the district court heard three hours of oral argument and then announced, in a 30-page opinion it read into the record, that it would accept the bankruptcy court's recommendation to confirm the plan of reorganization.¹¹⁷ The district court signed an order confirming the plan on August 8, 2003.¹¹⁸

113. Supplemental and Amendatory Order Making Additional Findings and Recommending Confirmation of Plan of Reorganization, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 10, 2003) (No. 03-10495 (JKF)) (on file with authors). While the court concluded that "additional notice" to persons with claims against only Basic or only Lummus but not CE "would have been preferred," it concluded that the notice that was actually given "is sufficient to comport with due process under the unique circumstances of this case." *Id.* at 7. The court added, however, that such "additional notice" to persons making non-derivative claims against non-debtors "will be expected in the future," presumably in other bankruptcy cases. *Id.*

114. See, e.g., Notice of Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 3, 2003) (No. 03-10495 (JKF)) (on file with authors) (filed by dissident asbestos claimants styling themselves "Certain Cancer Claimants"); Notice of Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 3, 2003) (No. 03-10495 (JKF)) (on file with authors) (filed by Joseph P. Rice, the so-called "Claimants' Representative"); Notice of Appeal of Century Indemnity Company, Pacific Employers Insurance Company, and Central National Insurance Company of Omaha, and Alternative Request for De Novo Review, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 21, 2003) (No. 03-10495 (JKF)) (on file with authors); Amended Notice of Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 18, 2003) (No. 03-10495 (JKF)) (on file with authors) (filed by The Travelers Indemnity Company and Certain Affiliates and Travelers Casualty and Surety Company); Notice of Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 18, 2003) (No. 03-10495 (JKF)) (on file with authors) (filed by First State Insurance Co. and Hartford Accident and Indemnity Co.); Notice of Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 18, 2003) (No. 03-10495 (JKF)) (on file with authors) (filed by London Market Insurers). The bankruptcy court subsequently granted a motion by Mr. Rice to stay pending appeal the portion of the confirmation order which required him to notify his clients of the bankruptcy court's conclusion that he had a conflict of interest. See Order Granting Joseph F. Rice's Motion to Stay Order Pending Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 11, 2003) (No. 03-10495 (JKF)) (on file with authors). The district court later reversed and vacated this portion of the bankruptcy court's confirmation order, finding that the bankruptcy court lacked subject matter jurisdiction over Mr. Rice's arrangements with his clients. See Opinion and Order, *In re Combustion Eng'g, Inc.* (D. Del. Sept. 15, 2003) (Bankr. No. 03-10495 (JKF)) Dist. No. 03-755 (AMW)) (on file with authors).

115. CE and its parent company, ABB, Inc., appealed from the bankruptcy court's refusal to include Basic and Lummus within the channeling injunction issued pursuant to Section 524(g) of the Bankruptcy Code. See Plan Proponents' Brief in Support of Appeal of the Bankruptcy Court's Denial of Section 524(g) Injunction as to ABB Lummus Global, Inc. and Basic, Inc. at 2-3, *In re Combustion Eng'g, Inc.* (D. Del. July 24, 2003) (No. 03-10495 (JKF)) (on file with authors).

116. See Order, at 2-3, *In re Combustion Eng'g, Inc.* (D. Del. July 18, 2003) (No. 03-10495 (JKF)) (on file with authors).

117. Transcript of Proceedings, at 138:8-168:10, *In re Combustion Eng'g, Inc.* (D. Del. July 31, 2003) (No. 03-10495 (JKF)) (on file with authors).

118. See Revised Proposed Confirmation Order, *In re Combustion Eng'g, Inc.* (D. Del. Aug.

Whether or not CE's plan ultimately succeeds is still an open question at this writing, as implementation of the plan has been deferred pending resolution of the appeals to the Third Circuit. It remains to be seen whether the appeals will gain any traction from the district court's acknowledgement that "the predominant opposition theme, to put it bluntly, is that this plan represents a corrupt attempt by solvent companies to obtain the benefits of a channelling injunction by bribing the plaintiffs' bar" through "immediate payment to present claimants, from whom counsel will recoup their fees, at the expense of future claimants, who may be far sicker but who represent a far less certain source of revenue for counsel."¹¹⁹ Although the district court made clear that it "rejected the interstitial arguments that support these larger themes," it also made clear that its approval of the plan did not mean "that the Court is enamored with the process by which it evolved. The courts and the public deserve a process that is not so easily impugned with charges of conflicts of interest and tainted votes, whether those charges are ultimately proved or not."¹²⁰

IV. THE PROBLEMS WITH PRE-PACKAGED ASBESTOS BANKRUPTCIES

The pre-packaged asbestos bankruptcies that have been filed so far pervert and distort the purposes of Section 524(g) of the Bankruptcy Code. This results from a variety of factors, including the following:

(1) The plan negotiations take place in secret, with the result that a select group of claimants whose lawyers know about the negotiations receive favorable treatment relative to the interests of other similarly situated claimants;

(2) The Future Claimants' Representative is presented with a stacked deck, and is therefore unable adequately to represent the interests of future claimants;

(3) The debtor is frequently negotiating with someone else's money, and has no incentive to cut a deal that protects the assets of those funding the plan; and

(4) Conflicts of interest are rife in the process.

There is a reason that it takes years for the parties to reach agreement in "conventional," non-pre-packaged asbestos bankruptcies: all parties are present during the negotiations, all are vigorously advancing the conflicting interests of their respective constituencies, the negotiations themselves are complex, and it takes a long time to reach an agreement in such

8, 2003) (Bankr. No. 03-10495 (JKF)) (on file with authors).

119. Transcript of Proceedings at 166:9–16, *In re Combustion Eng'g, Inc.*, (Bankr. D. Del. July 31, 2003) (Bankr. No. 03-10495 (JKF)) (on file with authors).

120. *Id.* at 166:17–18, 167:2–6.

circumstances. The reason it takes far less time to reach deals in pre-packaged cases is that most of the checks and balances in the plan process are absent, and provisions of the Bankruptcy Code designed to protect the rights of parties in interest are typically honored only in the breach. Courts should refuse to confirm plans that result from such skewed negotiations.

A. *The Interests Of The Parties in an Asbestos Bankruptcy*

An asbestos defendant that is contemplating filing for bankruptcy to resolve its asbestos liability problems has two primary concerns: (i) it wants to solve its asbestos liability problem at the lowest possible net financial cost to the company; and (ii) it wishes to maintain as much of the existing equity interests as possible for current shareholders, particularly where the company is both a healthy enterprise apart from asbestos concerns and is a subsidiary of a company that would like to capture as much as possible of the prospective debtor's future profits for its own benefit. The parent company, which may or may not become a debtor, wants to eliminate any asbestos-related "overhang" or "drag" on its stock price by seeing that it, its subsidiary the prospective debtor, and all of the parent's other subsidiaries and affiliates become "asbestos-free" through use of the Bankruptcy Code.

The asbestos claimants' interests are also clear: they want as much of the debtor's cash and stock as they can obtain. In a conventional, non-pre-packaged asbestos bankruptcy case, the claimants are represented in negotiations with the debtor by two separate entities, the official committee of asbestos claimants (which represents current claimants), and the Future Claimants' Representative (who represents future claimants). While both the committee and the Future Claimants' Representative have a common interest in forcing the debtor to contribute as much cash and stock as possible, once that goal is achieved they have opposing interests concerning how such consideration is divided between the current and future claimants. In essence, they are playing a zero-sum game: each dollar or share of stock allocated to the future claimants is at the expense of the current claimants, and vice versa.

In these negotiations, each party can look to various provisions of the Bankruptcy Code that give it some leverage. The current asbestos claimants must be satisfied because no channeling injunction may be issued unless a supermajority of 75 percent of voting asbestos claimants vote in favor of the plan.¹²¹ These claimants and the future claimants' representative

121. See 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb) (2000). The future claimants do not get a vote since, by definition, any person who is able to assert a claim is not a future claimant. See 11 U.S.C. § 524(g)(5). However, future claimants' representatives have asserted that no channeling injunction may be issued without their endorsement. See Futures Representative's Informational

together can insist that the debtor and its parent company must give them at least 50% of the equity interests in the debtor.¹²² They can demand additional consideration as a basis for agreeing to include the debtor's parent and affiliates within the protection of the channeling injunction.¹²³ The debtor's parent company or other owners will negotiate to keep at least 49.9 percent of their equity stakes, but accomplishing that goal will require that they provide other consideration satisfactory to the asbestos claimants. In short, all of the debtor's assets (and, to a large extent, those of its affiliates) are in play in the negotiations.¹²⁴ The debtor has some leverage too: its exclusive right to file a plan, which is commonly extended for periods amounting to years.¹²⁵

In a conventional bankruptcy case, the official committee of asbestos claimants is appointed by the U.S. Trustee and, like all official committees, has fiduciary duties to all of its constituents.¹²⁶ Thus, every asbestos claimant, regardless of who their personal lawyer is, is assured that his or her interests will be fully represented during the plan negotiations, without any favoritism or discrimination. Because the negotiations commence after the case is filed, the court-appointed future claimants' representative—another fiduciary—is able to participate in the negotiations from the outset, without having his or her hands tied by previously-agreed to deals.

In many of the recent large “conventional” asbestos bankruptcies, insurance coverage has not been a core concern of debtors or claimants, because insurance has long since been exhausted or settled.¹²⁷ Where such issues do exist however, insurers have the ability to participate in the bankruptcy case in a meaningful way where their interests are affected.¹²⁸

Brief and Preliminary Response to Disclosure Statement, at 20–25, *In re The Babcock & Wilcox Co.* (Bankr. E.D. La. Apr. 17, 2001) (No. 00-10992) (on file with authors). If this argument were to be adopted, then future claimants' representatives would effectively have a plan veto.

122. 11 U.S.C. § 524(g)(2)(B)(i)(III).

123. 11 U.S.C. § 524(g)(4)(A)(ii).

124. It is also frequently the case in a conventional asbestos bankruptcy case that the committees aggressively seek to pursue avoidance claims under 11 U.S.C. §547 (preferences) and/or 11 U.S.C. §548 (fraudulent conveyances) in order to maximize the assets potentially available for paying the claims of both current and future asbestos claimants. *See, e.g., In re W.R. Grace & Co.*, 281 B.R. 852, 860 (Bankr. D. Del. 2002); *In re Babcock & Wilcox Co.*, 274 B.R. 230, 257 (Bankr. E.D. La. 2002).

125. 11 U.S.C. § 1121; *see also supra* notes 13–15.

126. 11 U.S.C. §1102(a)(1); *see In re Caldor, Inc.*—N.Y., 193 B.R. 165, 169 (Bankr. S.D.N.Y. 1996) (“A creditor committee stands as a fiduciary to the class of creditors it represents.”); *In re Microboard Processing, Inc.*, 95 B.R. 283, 285 (Bankr. D. Conn. 1989) (“A committee and the holders of claims who serve on it only have a fiduciary duty to the parties or class represented.”).

127. Mark D. Plevin, *Current Insurance Issues In Major Asbestos Bankruptcies*, 1 MEALEY'S ASBESTOS BANKR. REPORT 4, November 2001, at 26.

128. *See, e.g., id.*

Very little of the foregoing model is reflected in the recent pre-packaged asbestos bankruptcies. Instead, pre-packaged bankruptcies have so far proven to be a world unto themselves, turning many of the rules and requirements of the Bankruptcy Code on their head.

B. Secret Negotiations

In a conventional asbestos bankruptcy case, the debtor negotiates in the open with both an official committee of asbestos claimants appointed by the U.S. Trustee in the bankruptcy case, and a court-appointed Future Claimants' Representative. This is not true in an asbestos pre-pack. Instead of negotiating under the spotlight of a public bankruptcy court proceeding, the negotiations typically take place in secret. And instead of negotiating with an official committee and a court appointee, the prospective debtor hand-picks its negotiation partner (usually, someone who is thought to control a large block of asbestos claimants). Sometimes in a pre-pack, the prospective debtor (or its affiliates) take steps, which would never be permitted in a bankruptcy case, that are designed to make its negotiating partner beholden to it. For example, in the *Combustion Engineering* case, the debtor's ultimate parent company, ABB Ltd., negotiated with a single claimants' attorney (dubbed the "Claimants' Representative" in the CE plan) to whom ABB agreed to pay \$20 million.¹²⁹ The bankruptcy court determined that the "Claimants' Representative" "has an actual conflict of interest in this case" because "[h]e is being paid \$20 million by the parent of an entity he is suing . . . he has tort clients who have claims against Debtor and/or another ABB related entity and he has contingency fee agreements with those clients who will be or have been paid through the CE Settlement Trust . . . and/or by the Asbestos PI Trust."¹³⁰

129. Transcript of Proceedings, at 125:5–18, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors). See Alex Berenson, *A Cauldron of Ethics and Asbestos*, N.Y. TIMES, March 12, 2003, at C1.

130. *In re Combustion Eng'g, Inc.*, 295 B.R. 459, 478 (Bankr. D. Del. 2003). Despite this finding and the further conclusion that "the process by which Mr. Rice was identified as the 'Claimants' Representative' at times and not at others and the \$20 million fee to be paid is inappropriate," the court concluded that "I have no jurisdiction to compel repayment or to prevent payment by ABB Limited." *Id.* at 479. The court did, however, bar the "Claimants' Representative" from further involvement with the post-petition asbestos trust as a trustee or a member of the court-appointed trust advisory committee. *Id.* The court also adopted certain restrictions on the extent to which the "Claimants' Representative" could be paid contingent fees. See *id.* at 478. Still, the court concluded that "the prepetition vote was not tainted under the unusual circumstances of this case" and "there was no prejudice created by the misrepresentation that Mr. Rice was Claimants' Representative." *Id.* at 477, 479.

After the bankruptcy court issued an order recommending confirmation of the plan, the "Claimants' Representative" filed an appeal of the confirmation order and subsequently moved successfully to stay pending appeal those parts of the order that require him to notify his clients of

Moreover, since the persons negotiating the pre-pack on behalf of the claimants do not owe fiduciary duties to all claimants, they are free to negotiate terms that primarily benefit their own clients and, perhaps, a small subset of additional claimants. ABB's negotiating partner in Combustion Engineering was steadfast in his insistence that he was not acting on behalf of all asbestos claimants in his negotiations with ABB and CE, but instead was simply representing his own clients.¹³¹ It is perhaps not surprising that a dissident group of asbestos claimants, all cancer victims (as opposed to the clients of ABB's negotiating partner, who included a large group of claimants not suffering from cancer), asserted that their interests had not been protected in the negotiations. Indeed, these dissident claimants asserted that the "Claimants' Representative" had tipped off his friends in the plaintiffs' bar about an impending deadline for submitting claims to the pre-petition trust, thereby allowing these claimants to be paid on far more favorable terms than the dissidents' claims, which would be relegated to the post-petition trust and paid far less generously.¹³²

The now-common structure used in asbestos pre-packs—a pre-petition trust that pays a subset of current claimants nearly full value for their claims, followed by a post-petition trust that pays other current claimants and future claimants a much smaller percentage of their claims, with significantly more stringent qualifying requirements—financially benefits

his conflict and seek a waiver from each of them. See Motion of Joseph F. Rice To Stay Order Pending Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 9, 2003) (No. 03-10495 (JKF)) (on file with authors); Order Granting Stay Pending Appeal, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. July 11, 2003) (No. 03-10495 (JKF)) (on file with authors). One wonders how the bankruptcy court could possibly have found that a plan chiefly negotiated by a "Claimants' Representative" with an actual conflict of interest due to his agreement to receive improper payments from one of the debtor's affiliates complies with the confirmation requirements found in 11 U.S.C. §1129(a)(1)–(4). While the district court approved the plan on appeal, it vacated the portion of the bankruptcy court's confirmation order concerning the "Claimants' Representative," concluding that the bankruptcy court lacked subject matter jurisdiction over the "Claimants' Representative's" arrangements with his clients. See Opinion and Order, *In re Combustion Eng'g, Inc.* (D. Del. Sept. 15, 2003) (Bankr. No. 03-10495 (JKF), Dist. No. 03-755 (AMW)) (on file with authors).

131. See, e.g., Transcript of Proceedings, at 53:22–54:8, 131:7–9, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

132. See, e.g., Objection of Certain Cancer Claimants to Debtor's Motion to Approve Disclosure Statement, Solicitation Procedures and Pre-Packaged Plan of Reorganization ¶¶ 91, 95, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Mar. 26, 2003) (No. 03-10495 (JKF)) (on file with authors); Complaint for Injunctive Relief to Prevent Disbursements from the CE Settlement Trust, Pre-Petition Committee of Select Asbestos Claimants v. Combustion Eng'g Inc. (*In re Combustion Eng'g Inc.*), (Bankr. D. Del. Feb. 27, 2003) (No. 03-50995) (on file with authors). The reason the dissident claimants forced CE to file its case before the preference period ran on CE's transfers to the pre-petition trust was to preserve the ability to seek recovery of those transfers, in order to bring those funds into the debtor's estate and equalize the treatment of all asbestos claimants. See *In re Combustion Eng'g, Inc.*, 292 B.R. 515, 519 (Bankr. D. Del. 2003).

the lawyers for the preferred claimants, since they typically receive, as contingent fee payments, as much as 40 cents of each dollar paid to their claimants. Because their clients get paid more, and sooner, than other claimants, these lawyers personally benefit when the plan is structured in such a fashion. If the plan treated all claimants the same, paying all current claimants through the mechanism of a post-petition trust, the lawyers for the current claimants would make less money—even assuming the bankruptcy court or the trust made no effort to restrict the portion of a trust beneficiary’s payment that could be paid as a contingent fee.¹³³ This, as much as anything, explains why asbestos pre-packs are structured in such a byzantine fashion that is so different than any “conventional” asbestos bankruptcy case.

C. Favorable Treatment for Certain Current Claimants

Similarly situated claimants in pre-packs generally do not receive similar treatment despite the fact one of the hallmarks of the Bankruptcy Code is the requirement that “a plan shall . . . provide the same treatment for each claim or interest of a particular class. . . .”¹³⁴ This unequal treatment manifests itself in several ways. First, as suggested above, there is typically a large discrepancy between what is paid to claimants who qualify for payment under the pre-petition trust and those who must look solely to the post-petition trust. In *J.T. Thorpe*, for example, some current claimants were paid in full, right before the filing of the bankruptcy case, by the pre-petition trust; other current claimants received full or partial security interests for their claims against the post-petition trust; still other current claimants did not receive any security, and faced the prospect of being paid only pennies on the dollar by the post-petition trust (and, in contrast to those current claimants paid before the bankruptcy case was filed, would be paid only after a considerable delay).¹³⁵ Similarly, in *Combustion Engineering*, claimants qualifying for payment from the pre-petition trust received as much as 95 percent of their claims in cash prior to, and even during, the bankruptcy case, while claimants against the post-petition trust

133. The bankruptcy court may have power, pursuant to 11 U.S.C. § 1129(a)(4) (2000), to regulate the payments made to claimants’ attorneys on account of claims submitted to a trust established pursuant to a plan. The court would seem to have no similar power to regulate payments made pre-petition.

134. 11 U.S.C. § 1123(a)(4).

135. See Collateral Trust Agreement, Exhibit G to the Disclosure Statement §§ II(A)(2), (A)(3), *In re J.T. Thorpe Co.*, (Bankr. S.D. Tex. Oct. 1, 2002) (No. 02-41487-H5-11) (on file with authors); Settlement Agreement between J.T. Thorpe Company and Various Asbestos Claimants, Exhibit H to the Disclosure Statement § II(A), *In re J.T. Thorpe Co.* (Bankr. S.D. Tex. Oct. 1, 2002) (No. 02-41487-H5-11) (on file with authors).

were likely to receive much lower recoveries.¹³⁶ Since future claimants cannot qualify for payment by the pre-petition trusts, they will receive much lower recoveries than current claimants with similar diseases or conditions. This appears to be squarely at odds with the requirement in Section 524(g) of the Bankruptcy Code that “present claims and future demands that involve similar claims” must be paid “in substantially the same manner.”¹³⁷

Second, even those claimants lucky enough to be paid by the pre-petition trust, in whole or in part, are not treated equally. In both *J.T. Thorpe* and *Combustion Engineering*, the amount that a current claimant is paid by the pre-petition trust is a function of the “matrix” or schedule of values applicable to claims by clients of particular attorneys. Thus, a client of Attorney A may get paid twice as much as a client of Attorney B with the same disease or condition.¹³⁸ Although outside of bankruptcy the litigation results obtained by otherwise similarly-situated claimants often vary based on a wide variety of subjective factors (including the skill and reputation of each claimant’s lawyer), this is not an acceptable result in a bankruptcy context where similar claimants are to be treated similarly.¹³⁹ In this sense, the pre-petition trust, created with knowledge of an imminent bankruptcy filing, circumvents the policy and provisions of the Bankruptcy Code.

Yet another difference in treatment of similarly-situated claimants is that those entitled to be paid by the pre-petition trust also enjoy the benefit of a far less stringent evaluation to determine entitlement to compensation. This disparity was highlighted in *Combustion Engineering* by the cancer claimants who opposed the plan:

Unlike the generous approval process garnered for the CE Settlement Trust [pre-petition trust] participants, claims submitted to CE after the arbitrary cut-off date of November 14, 2002 are to be

136. See Disclosure Statement, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. 2003) (No. 03-10495 (JKF)) (on file with authors); Informational Statement of the Pre-Petition Committee of Select Asbestos Claimants, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. 2003) (No. 03-10495 (JKF)) (on file with authors). Unlike the case in *J.T. Thorpe*, where the pre-petition trust ceased making payments once the bankruptcy case was filed, the pre-petition trust in *Combustion Engineering* continued to make payments even after the bankruptcy case was filed. Certain claimants who alleged they had been improperly excluded from participation in the pre-petition trust sought a temporary restraining order enjoining these post-petition payments, but their request was denied. See *In re Combustion Eng’g, Inc.*, 292 B.R. 515, 521 (Bankr. D. Del. 2003).

137. 11 U.S.C. § 524(g)(2)(B)(ii)(V).

138. See Transcript of Proceedings, at 70:6–17, *In re J.T. Thorpe Co.* (Bankr. S.D. Tex. Dec. 18, 2002) (No. 02-41487-H5-11) (on file with authors); Transcript of Proceedings, at 77:23–78:23, 79:8–11, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

139. See 11 U.S.C. § 1123(a)(4) (2000).

scrutinized under a much higher standard for approval. CE's proposed pre-packaged plan and Asbestos PI Trust [the post-petition trust] require these claimants to produce exposure and medical evidence not required of the CE Settlement Trust participants. On information and belief, many of the claims of CE Settlement Trust participants, if reviewed at all, have been approved without meaningful evidence of a doctor's diagnosis of disease, physical exam, and certainly no pulmonary function testing. Yet all claims submitted after November 14, 2002 must satisfy this higher criteria for diagnosis of disease, occupational exposure and exposure to CE products.¹⁴⁰

Why are a select group of current claimants given preferential treatment? The answer is obvious: to induce them to vote in favor of the pre-packaged plan in large enough numbers to meet the 75% "supermajority" requirement in Section 524(g).¹⁴¹ Those lawyers who control large "inventories" of asbestos claims, as they sometimes impersonally and inelegantly refer to their clientele, must have their demands satisfied, or they will vote against the plan (as they typically assert they can do, without client consultation, in reliance on broad powers of attorney granted at the outset of the representation). The lawyers with the largest number of clients, who can therefore deliver the most votes, therefore have the power and leverage to negotiate the highest "matrix values" for their clients.¹⁴² Naturally, those lawyers who control fewer votes have less ability to negotiate high matrix values. The result is that the amount a claimant recovers varies based not on the merit of his or her claim but, instead, on the identity of his or her counsel.

Why not pay all the current claimants at the highest matrix values? Presumably all attorneys for current claimants would agree on that as an ideal, but it is not achievable in a world of limited funding availability, since considerable value must be set aside for payment of future claimants and those current claimants who, for one reason or another, do not participate in the pre-petition trust. In *Combustion Engineering*, for example, CE and its affiliates agreed with the "Claimants' Representative" that approximately half the company's value would pay claims of current

140. Objections And Response Of Unofficial Committee Of Select Asbestos Claimants To Motion For Entry Of An Order Pursuant To 11 U.S.C. §§ 105, 363, 365 and Fed. R. Bankr. P. 9019, Approving The Debtor's Entry Into Adoption Agreements Of The Master Settlement Agreement With Various Asbestos Claimants And Authorizing The Debtor To Continue To Enter Into Adoption Agreements ¶ 14, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Mar. 13, 2003) (No. 03-10495 (JKF)) (on file with authors).

141. See 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb).

142. High matrix values, combined with percentage-based contingent fee arrangements, leads, of course, to higher attorney compensation.

claimants against the pre-petition trust and the other half would be used to pay the claims against the post-petition bankruptcy trust.

The settlement agreement in *Combustion Engineering* paid some current claimants 95%, others 85%, and still others up to 75% of their claims, with a “stub claim” left over for payment in the bankruptcy case. Why not simply pay the claims in full through the pre-petition trust? The answer lies, again, in the requirement of a supermajority vote in favor of the plan. If the claims were paid in full before the bankruptcy case, the claimants would not be eligible voters, and there would not be any basis to confirm a plan under Section 524(g) of the Bankruptcy Code. Thus, the pre-petition trusts are artificially constructed to pay almost all of the claim, but to leave over something that could be voted in favor of the plan.

There is some dispute about whether participation in the pre-petition trust is dependent on a commitment to vote in favor of the plan, which could be assailed as improper vote-buying. For example, the Settlement Agreement with J.T. Thorpe provided that the participating claimants and their representatives agreed to support and not oppose the J.T. Thorpe plan of reorganization to the extent that the plan conformed to the term sheet attached to the Settlement Agreement.¹⁴³ In *Combustion Engineering*, the dissident claimants asserted that CE required those participating in the pre-petition trust to commit, as a condition of being paid by the pre-petition trust, to support the plan by voting in favor of it.¹⁴⁴

D. The Future Claimants’ Representative Has Only A Limited Ability to Negotiate Plan Terms

In a “conventional” asbestos bankruptcy, the court-appointed Future Claimants’ Representative is involved in the plan negotiations from the outset. His ability to negotiate favorable terms on behalf of his constituents is a function of: (i) his skill as a negotiator and that of his lawyers, and (ii) the leverage afforded by the provisions of the Bankruptcy Code to insist that at least 50% of the stock of the debtor and others is made available for

143. Settlement Agreement between J.T. Thorpe Company and Various Asbestos Claimants, Exhibit H to the Disclosure Statement, at § VIII, *In re* J.T. Thorpe Co. (Bankr. S.D. Tex. Oct. 1, 2002) (No. 02-41487-H5-11) (on file with authors).

144. See Objection of Certain Cancer Claimants to Debtor’s Motion to Approve Disclosure Statement, Solicitation Procedures and Pre-Packaged Plan of Reorganization ¶ 16, *In re* Combustion Eng’g, Inc. (Bankr. D. Del. Mar. 26, 2003) (No. 03-10495 (JFK)) (on file with authors). This was a contested issue in *CE*; debtor responded that the dissident objectors were simply wrong, and that support for the plan was not a condition of participation in the pre-petition trust. See Proposed Findings of Fact and Conclusions of Law Regarding Approving the Disclosure Statement and Confirming the Plan of Reorganization for Combustion Engineering, Inc. ¶ 44, *In re* Combustion Eng’g, Inc. (Bankr. D. Del. May 13, 2003) (No. 03-10495 (JFK)) (on file with authors).

payment of such claims.¹⁴⁵ All of the assets of the debtor and its affiliates are on the negotiating table for discussion. As a historical matter, in many “conventional” asbestos bankruptcies the claimants have ended up with majority ownership of the company. That way, the profits thrown off by the company once it is freed from asbestos liability, and any increase in the value of the company’s stock, benefit the claimants the company allegedly harmed.

In pre-packs, however, the hands of the person chosen by the debtor to negotiate plan terms on behalf of future claimants¹⁴⁶ are tied by the terms of the deal already negotiated by the debtor and its hand-selected negotiating partner. In both *J.T. Thorpe* and *Combustion Engineering*, the debtor did not select a prospective future claimants’ representative until after the pre-petition trust had already been established and funded.¹⁴⁷ In *Combustion Engineering*, for example, this meant that approximately \$400 million of the prospective debtor’s assets—approximately one-half its total assets—was already irrevocably committed to payment of current claims because the funds had been transferred to the pre-petition trust for payment of current claims.¹⁴⁸ This means that the future claimants’ representative could only negotiate for what was left, since half the debtor’s value was already off the table.¹⁴⁹

145. See 11 U.S.C. § 524(g)(2)(B)(i)(III) (2000) (providing that the trust “is to own, or by the exercise of rights granted under such plan would be entitled to own if specified contingencies occur, a majority of the voting shares of – (aa) each such debtor; (bb) the parent corporation of each such debtor; or (cc) a subsidiary of each such debtor that is also a debtor. . . .”).

146. The asbestos bankruptcy cases that first established the need for a future claimants’ representative did not place the authority to select this individual in the hands of the debtor. In *Johns-Manville*, the future claimants’ representative was selected by the court. See *In re Johns-Manville Corp.*, 52 B.R. 940, 942 (S.D.N.Y. 1985). In *UNR*, the United States Trustee was given an exclusive 20-day period to nominate the future claimants’ representative. See *In re UNR Indus., Inc.*, 46 B.R. 671, 677 (Bankr. N.D. Ill. 1985).

In the CE bankruptcy, the official creditors’ committee suggested that the inability of a court to appoint a future claimants’ representative to negotiate the terms of a pre-packaged bankruptcy plan makes the use of the pre-pack mechanism infeasible in an asbestos bankruptcy. See Official Committee of Unsecured Creditors’ Objection to Debtor’s Motion for Entry of an Order Approving and Authorizing the Appointment of David Austern as the Legal Representative for Future Asbestos Claimants ¶¶ 16–17, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. Mar. 13, 2003) (No. 03-10495 (JKF)) (on file with authors).

147. See Transcript of Proceedings, at 166:20–25, *In re J.T. Thorpe Co.* (Bankr. S.D. Tex. Dec. 18, 2002) (No. 02-41487-H5-11) (on file with authors); Transcript of Proceedings, at 345:20–346:25, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors).

148. Transcript of Proceedings, at 68:12-21, *In re Combustion Eng’g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)) (on file with authors); *In re Combustion Eng’g, Inc.*, 292 B.R. 515, 519 (Bankr. D. Del. 2003).

149. In *J.T. Thorpe*, the bankruptcy case was purposefully filed more than 90 days after the pre-petition trust was funded, in an effort to insulate payments to the pre-petition trust from challenge as preferential under 11 U.S.C. § 547. That was not the case in *Combustion*

Moreover, in undertaking the pre-petition negotiations the prospective future claimants' representative only has access to such information as the debtor elects to provide. This is also unlike the case in a "conventional" bankruptcy, where the court-appointed Future Claimants' Representative can, if necessary, use the discovery devices made available by the Bankruptcy Rules to compel disclosure of information. Without such devices, even expensive "due diligence" efforts can fall short. For example, while the prospective future claimants' representative in *Combustion Engineering* engaged a wide variety of professionals at a cost of more than \$1 million to assist him in analyzing information made available by the prospective debtor and its affiliates, he was not advised, until after the bankruptcy case was filed, that certain insurer indemnity claims threatened to consume the entirety of the trust assets to be made available for payment of future claims.¹⁵⁰ He testified at the confirmation hearing that if he had been told of that fact during the pre-petition plan negotiations, it might have caused him to reconsider his publicly-announced support for the plan.¹⁵¹

Finally, there is the reality that the prospective debtor is the one who selected and is paying the person assigned the role of negotiating the pre-pack on behalf of future claimants. The prospective debtor is also the one paying the professionals retained by the prospective future claimants' representative. While this appears on its face to be similar to what would happen in the bankruptcy case—where the court-appointed Future Claimants' Representative and his or her professionals would be paid by the estate, subject to the supervision of the bankruptcy court—it is actually not the same, because there is no judicial scrutiny of the fees, and the prospective debtor has a measure of control that it does not have once a bankruptcy case is actually commenced. Further, because the person representing future claimants is not a court appointee when the negotiations are taking place, the debtor has the ability to terminate him or her if the

Engineering, where threats by dissident claimants of an involuntary Chapter 7 filing forced CE to file its pre-pack within the preference period. *In re Combustion Eng'g, Inc.*, 292 B.R. 515, 519 (Bankr. D. Del. 2003). Where, however, the debtor has committed to a pre-pack, the chances that the debtor will later upset the deal by initiating a preference suit are minuscule, and the ability of other claimants to assert such claims is very limited. See, e.g., *Official Committee v. Chinery (In re Cybergenics Corp.)*, 304 F.3d 316 (3d Cir. 2002), *rev'd en banc*, 330 F.3d 548 (3d Cir. 2003). Moreover, a prospective future claimants' representative who wished to preserve a possible preference action would appear to have no ability, on his own, to initiate an involuntary bankruptcy case against the prospective debtor designed to stop the 90-day period from running, since the representative is not himself a holder of a claim against the estate and 11 U.S.C. § 303(b)(1) contains no provisions expressly authorizing the filing of an involuntary case by someone acting in a representative capacity.

150. Transcript of Proceedings, at 339:18–23, 340:17–341:2, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. May 1, 2003) (No. 03-10495 (JKF)).

151. *Id.* at 341:7–9.

negotiations get too tough. And while it is common for the debtor in a pre-pack to ask the court to appoint the pre-petition prospective future claimants' representative as the Future Claimants' Representative in the bankruptcy case, the appointment is close to meaningless, since the terms of the plan are already set.¹⁵²

It is perhaps the most notable feature of the recent asbestos pre-packs that ownership of the debtors has remained entirely with their parent companies.¹⁵³ Not only is this contrary to what happens in most conventional asbestos pre-packs, it is arguably contrary to what Congress intended when it enacted Section 524(g) of the Bankruptcy Code: that in exchange for a broad channeling injunction making a debtor forever "asbestos free," the company should be required to both contribute at least 50% of its equity to the claimants and to make future payments to the trust, including dividends.¹⁵⁴ The fact that pre-packaged and conventional

152. While some modifications to a pre-packaged plan can be made post-petition, such modifications may not be "material," or else the plan must be re-voted.

The proponent of a plan may modify such plan at any time before confirmation, but may not modify such plan so that such plan as modified fails to meet the requirements of Section 1122 and 1123 of this title. After the proponent of a plan files a modification of such plan with the court, the plan as modified becomes the plan.

11 U.S.C. § 1127(a).

In a . . . Chapter 11 case, after a plan has been accepted and before its confirmation, the proponent may file a modification of the plan. If the court finds . . . that the proposed modification does not adversely change the treatment of the claim of any creditor or the interest of any equity security holder who has not accepted in writing the modification, it shall be deemed accepted by all creditors and equity security holders who have previously accepted the plan.

FED. R. BANKR. P. 3019. *See In re Cellular Info. Sys., Inc.*, 171 B.R. 926, 929 n.6 (Bankr. S.D.N.Y. 1994) (nonmaterial modifications to the plan do not require re-solicitation).

153. How can this be, given the requirement of 11 U.S.C. §524(g)(2)(B)(i)(III)? In each case, the plan provides that at least a majority of the debtor's stock will be contributed to the post-petition trust "if specified contingencies" occur. *Id.* For example, J.T. Thorpe's parent company agreed to contribute the stock of J.T. Thorpe to the post-petition trust if the reorganized debtor was unable to make payments on a \$2.3 million note – a de minimis sum. *See Transcript of Proceedings*, at 99:19–24, 101:15–21, *In re J.T. Thorpe Co.* (Bankr. D. Del. Dec. 18, 2002) (No. 02-41487-H5-11) (on file with authors). This is a far cry from giving majority control of the debtor to the claimants in exchange for the broad protection of the channeling injunction.

154. *See* 11 U.S.C. §§ 524(g)(2)(B)(i)(II), 524(g)(2)(B)(i)(III). The legislative history of Section 524(g) states: "[I]n order for present claimants to be bound by a trust/injunction . . . the trust must have the capability of owning a majority of the shares of the debtor" to ensure that "asbestos claimants would have a stake in [the debtor's] successful reorganization, because the company's success would increase [] the value of the stock. . ." H.R. REP. NO. 103-835, at 40–41. As one senator put it during the congressional debate on Section 524(g): "The reorganized company becomes the goose that lays the golden egg by remaining a viable operation and maximizing the trust's assets to pay claims. The injunction provision is simply about growing the pie available to pay victims. . . . The higher the value of the stock, the more value for the victims' trust." 140 CONG. REC. S4523–24 (1994) (statement of Sen. Heflin).

The fact that the asbestos claimants' trust in *Johns-Manville* ended up owning most of the company was a principal factor in that court's decision to approve the trust/injunction

asbestos bankruptcies have such discrepant outcomes is strong evidence that pre-packs fail to serve the interests of future claimants.

E. The Contorted Negotiation Process Which Allows Debtors To Enter Exorbitant Settlements Using Other People's Money Without Their Consent

The J.T. Thorpe pre-pack was notable for the fact that the prospective debtor was negotiating almost entirely with someone else's money: that of its insurers. And it was doing so against the insurers' will, over their objections. That meant that the parties who were responsible for funding the plan had no say in how their money was proposed to be spent.

In a typical negotiation, a party is loath to pay additional consideration because of the cost to the party. In *J.T. Thorpe*, however—or any other asbestos pre-pack which is largely an “insurance play,” in that the vast majority of the funding for the plan is to come from insurance—the prospective debtor is able to promise favorable payment terms at no cost to itself, because the cost would be borne by its insurers, to the extent coverage is established.¹⁵⁵ Thus, the insurers argued that the “trust distribution procedures” applicable to the post-petition trust, which govern the amount and terms on which claims against the trust would be paid, set the “allowed liquidated values” (or “ALVs”) for such claims at amounts considerably higher than J.T. Thorpe had paid to claimants pre-petition. J.T. Thorpe had no financial interest in negotiating for low ALVs, or strict qualification requirements, because it was not bearing any part of the cost of paying future claimants. And the insurers who would be bearing the cost had no ability to negotiate more acceptable terms, since they had no voice in the pre-petition plan negotiations.

The prospective debtor's principal interest was in negotiating a broad channeling injunction that would cover its entire corporate family at the lowest possible cost. J.T. Thorpe sought to achieve that goal by, in effect, paying current claimants and their lawyers in full, or nearly so, prior to the commencement of the bankruptcy case, so they would agree to permit J.T.

mechanism that Congress subsequently enacted in Section 524(g). *In re Johns-Manville Corp.* 68 B.R. 618, 621–22 (Bankr. S.D.N.Y. 1986) (noting that the plan, by making the trust “the single largest stockholder in the reorganized debtor,” would give “the ‘tort victims’ the beneficial interest in the ongoing corporate entity.”).

155. To be sure, the insurers in *J.T. Thorpe* objected to the debtor's attempted confiscation of their funds. Of note, however, is that the financial risk that the insurers' objections would be sustained is not at all on the debtor. That risk is, rather, borne entirely by the future claimants – who had no vote on whether or not to bear that risk. The actual amount future claimants will be paid depends almost entirely on how much funding is eventually obtained from a hotly disputed insurance asset that is currently subject to coverage litigation. If the coverage litigation were to be largely unsuccessful, the pay-outs to future claimants would be severely diminished.

Thorpe's parent company to retain its 100% ownership interest in the company,¹⁵⁶ and the issuance of a broad channeling injunction would protect J.T. Thorpe, its parent company, and all of their affiliates. It then sought to paper over the discrepancy between how current claimants and future claimants are treated by agreeing to ALVs for future claimants that are considerably higher than the settlement amounts it was paying before the pre-pack negotiations commenced. Those high ALVs are to be paid by insurers, not J.T. Thorpe, meaning that the insurers, in effect, would be required to pay exorbitant claim values so J.T. Thorpe's parent company could maintain its equity in the debtor post-petition—a distortion of both bankruptcy law and contract rights.¹⁵⁷

F. The Settlements Comprising Pre-Packs Typically Violate Insurer Rights in Ways that Jeopardize the Recoveries Of Future Claimants

The manner in which pre-packs are negotiated jeopardize the very insurance coverage proceeds that the future claimants largely depend on for payment of their claims.

Insurance policies typically contain provisions that, among other things, grant an insurer the right to control (or associate in) the defense and settlement of any claims it is called upon to pay. Under such provisions, settlements are not binding on (*i.e.*, need not be reimbursed by) the insurer if the insurer did not consent to the settlement in writing. A pre-pack is, of course, a settlement among the prospective debtor, the person(s) negotiating on behalf of current claimants, and the prospective future claimants'

156. The plan nevertheless arguably complied with 11 U.S.C. § 524(g)(2)(B)(i)(III) because J.T. Thorpe's parent company agreed to contribute the stock of J.T. Thorpe to the post-petition trust if the reorganized debtor was unable to make payments on a \$2.3 million note – a *de minimis* sum.

157. The strange alliances that develop in pre-packaged asbestos bankruptcies between debtors wanting broad channeling injunctions and claimants wanting access to insurance money are exemplified by the prospective pre-packaged filing of Congoleum Corporation, *see supra nn. 48–51*. Although insurance policy provisions require policyholders and insurers to cooperate in defending against claims by asbestos claimants, Congoleum sought to resist a discovery request made by insurers in a pending coverage action for copies of its draft prepackaged plan and disclosure statement, which it had shared with claimants during plan negotiations, on the ground that it and the claimants had “a common interest with its creditors to maximize the assets” available to pay the asbestos claims against it. Letter Brief at 16, Congoleum Corp. v. ACE American Ins. Co., No. MID-L-8908 (Aug. 18, 2003 N.J. Super. Ct., Middlesex Cty.) (on file with authors). The special discovery master rejected Congoleum’s argument, stating that the negotiations between prospective debtors and asbestos claimants concerning prepackaged asbestos bankruptcies: “are negotiations between adverse parties, each party attempting to maximize its position in the face of an uncertain future. To say that they have a “common interest” in maximizing the assets of the corporation for the benefit of creditors is not reality.” Special Master Letter Ruling at 1, Congoleum Corp. v. ACE American Ins. Co., No. MID-L-8908 (Aug. 19, 2003 N.J. Super. Ct., Middlesex Cty.) (on file with authors).

representative. If the insurers do not consent to the settlement, it may not be binding on them and insurance proceeds may not be available to pay claims submitted as part of such a settlement. Since in most pre-packs the future claimants are largely dependent on insurance funding for payment of their claims, the fact that insurers typically are excluded from pre-pack negotiations threatens to result in the future claimants being paid nothing on their claims, even as current claimants get paid nearly in full.

In addition, the trust distribution procedures governing payment of post-petition claims in both *J.T. Thorpe* and *Combustion Engineering* fail to give the insurers any right to participate in the defense or settlement of claims submitted to the post-petition trusts. Not only does this appear to violate the insurers' contractual rights, it also may violate Section 502(a) of the Bankruptcy Code, which permits any party in interest to object to a claim against the debtor.¹⁵⁸ In essence, the trusts are private dispute resolution mechanisms that supplant the public judicial resolution of claims against the debtor. As the ones being called upon to pay such claims, insurers should be permitted to choose whether such claims may be handled privately or in bankruptcy court—particularly where they have, in addition to their statutory rights to object to claims, a contractual right to control (or associate in) the defense and settlement of claims.

In apparent recognition of the fact that their pre-packaged plans jeopardized the right to recover insurance proceeds, the bankruptcy plans of both *J.T. Thorpe* and *Combustion Engineering* originally contained provisions that conditioned plan confirmation on the bankruptcy court making findings that nothing in the plans or in the negotiations leading up to the plans shall be deemed to breach any term of the debtor's insurance.¹⁵⁹ Such plan provisions are ineffective, however, both because there generally are no facts to support such findings, and also because the relief sought amounts to a declaration of the insurers' and debtor's respective rights under the policies that cannot be granted as part of a confirmation hearing. Rather, such relief requires a full-blown adversary proceeding lawsuit,¹⁶⁰ which would be so time-consuming that it would make the pre-pack an

158. 11 U.S.C. § 502(a).

159. See Plan of Reorganization §§ 7.1(a)(16), (17), *In re J.T. Thorpe Co.* (Bankr. S.D. Tex. Oct. 1, 2002) (No. 02-41487-H5-11) (on file with authors); Plan of Reorganization §§ 7.10.1.4–7.10.1.9, *In re Combustion Eng'g, Inc.* (Bankr. D. Del. Feb. 19, 2003) (No. 03-10495 (JKF)) (on file with authors). In attempts to overcome or moot insurer objections to these provisions, both *J.T. Thorpe* and *Combustion Engineering* later withdrew most of these proposed insurance findings from their plans. See Stipulation and Order, *In re J.T. Thorpe Co.* (Bankr. S.D. Tex. Dec. 17, 2002) (No. 02-41487-H5-11) (on file with authors); Motion for Entry of Order Approving the Sixth Technical Modifications to Debtor's Plan of Reorganization, *In re Combustion Eng'g, Inc.* (Bankr. D. Del., May 13, 2003) (No. 03-10495 (JKF)) (on file with authors).

160. See FED. R. BANKR. P. 7001.

ineffective vehicle to accomplish a quick trip through bankruptcy court.

V. CONCLUSION

Companies facing tens of thousands of asbestos claims may view pre-pack bankruptcies as a panacea, in that they seem to provide a mechanism for quick and inexpensive relief from the asbestos litigation nightmare. However, experience has shown that this is not the case because such bankruptcies have drawn vigorous objections by persons claiming that pre-packaged asbestos bankruptcies, as currently practiced, violate the Bankruptcy Code and Rules, improperly treat some claimants more favorably than others, and disregard the contractual rights of the insurers expected to fund the payments under the plan. The order confirming one of these pre-packaged plans is currently stayed pending appeal and another is being contested in appellate litigation by claimants and insurers. If either of these challenges succeed, the days of the pre-pack—at least as currently practiced—may be numbered, and properly so, in our view.