A Field Guide for the Troops in the Trenches

§ 524(g) Asbestos Bankruptcies and Other Land Mines

By Ronald R. Robinson and Janet A. Shapiro

Protecting coverage strategies in two forums when your policyholder files Chapter 11.

Insurance professionals, in-house counsel or private practice litigators responsible for asbestos-related bodily injury coverage claims or litigation will, in a growing number of instances, confront an insured that elects to file a Chapter 11 bankruptcy petition. These insureds increasingly seek the protections afforded under Chapter 11 of the Bankruptcy Code, found at 11 U.S.C. §101, *et seq*, and, specifically, a §524(g) plan of reorganization and channeling injunction, applicable only to mass tort asbestos claims, which permanently prevents recovery of a claim against certain protected parties, described in more detail below. Instead, §524(g) requires plaintiffs to submit bodily injury claims to a settlement trust, also discussed in more detail below, that will evaluate and pay all present and future claims. 11 U.S.C. §524(g).

In the space of one day, the filing of a bankruptcy petition will result in an insurer's coverage litigation defense strategies being played out in two forums at once. This article focuses on what you can and should do to pursue your coverage litigation strategy and defenses successfully. Your success will largely depend on what steps you take in the critical pre-bankruptcy time period and the opening days of the bankruptcy case.

The requirements of §524(g) do not relieve parties from complying with the provisions of Chapter 11 of the Bankruptcy Code. For example, the §524(g) channeling injunction supplements the discharge injunction of §1141(d) of the Bankruptcy Code. Moreover, the Chapter 11 plan must also comply with the requirements of 11 U.S.C. §1129(a) ("Confirmation of plan"). Although the specific provisions of §524(g) are front and center in this article, the procedures and strategies discussed are applicable in Chapter 11 cases that do not involve asbestos or §524(g), and are useful in any kind of insurance coverage litigation that involves a bankruptcy filing by one or more of the litigating parties.

The Genesis of §524(g)

The goal of §524(g) is to create a plan of re-

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organization (reorganization plan) that will provide for an asbestos bodily injury claim settlement trust. The evolution of §524(g) is described in *Federal Insurance Company v. Grace,* Slip Copy, 2004 WL 5517843 (D. Del. 2004) at 4. Under the Bankruptcy Code, an insured becomes a debtor-in-possession (debtor), and even after filing, it continues to "possess" and control its business, as opposed to a trustee. The bankruptcy filing creates an estate that includes "all legal or equitable interests of the debtor in property as of the commencement of the case." *See* 11 U.S.C. §541(a). Property of the estate includes insurance policies. *The Minoco Group of Companies, Ltd. v. First State Underwriters Agency of New England Reinsurance Corp. (In re Minoco Group)*, 799 F.2d 517, 519 (9th Cir. 1986). The various issues surrounding whether a debtor can qualify for §524(g) protection are beyond the scope of this article.

The §524(g) Channeling Injunction

Generally, the debtor, along with its insurers and other third parties, often referred to as non-debtor third parties, will fund the claim settlement trust referred to above. *See* 11 U.S.C. §524(g)(2)(B)(i)(II). In consideration for the contribution of funds to the claim settlement trust, the debtor and the non-debtor third parties receive the protection of an injunction that "channels" all current and future asbestos claims to the trust for resolution. 11 U.S.C. §524(g) authorizes a bankruptcy court to confirm a reorganization plan that requests issuance of such an injunction. The claim settlement trust thereafter resolves all current and future asbestos claims. The order confirming a reorganization plan must be affirmed by a district court. *See* 11 U.S.C. §524(g)(3)(A).

When issued, the channeling injunction results in the debtor and non-debtor third parties to the bankruptcy case becoming protected parties. As mentioned above, all entities that hold current or assert future asbestos claims, or any other claims, are permanently enjoined from directly or indirectly recovering or receiving payment, if their claims are against a protected party. Their only remedy is to submit asbestos claims to the settlement trust and seek redress under its provisions. The settlement trust will evaluate and pay all previously filed asbestos bodily injury claims and will reserve adequate funds for future claims, *i.e.*, those arising after the reorganization plan and settlement trust are in place.

The Insured's §524(g) End Game

If a §524(g) reorganization plan is confirmed, the claim settlement trust will control the "defense," as well as the payment of all pending and future claims, including asbestos bodily injury claims, submitted to it. Thus, the reorganization plan's settlement payment amounts, which are utilized by the trust, and the trust's claim proof or evidence criteria will control. The claim resolution protections and options afforded an insurer by the insurance policy it issued to the insured—now a debtor—and the evidentiary and substantive laws that previously controlled those claims in the tort system may be significantly altered by a §524(g) bankruptcy reorganization plan and claim settlement trust.

Most alarmingly, the reorganization plan's proponents set the trust's claim settlement values and evidentiary payment requirements. Confirmation of the reorganization plan requires that its claim settlement values and evidence criteria be acceptable to and approved by a super majority of those who will submit claims for payment to the trust. (See discussion of Scheduled Claim Values and Trust Distribution Procedures below.) Thus, if a reorganization plan is confirmed, insurers will no longer be able to exercise the evidentiary and claim settlement value control granted under their insurance contracts and available in the tort system. This loss of control opens the door to "extra-contractual protections" being afforded an insured and its claimants; *i.e.*, higher claim values and lower evidentiary criteria than would be present under their policy and in the tort system. Thus, the loss of insurer control over its insured's claims is an inherent risk in a §524(g) bankruptcy and it in turn raises the stakes in pending coverage litigation.

The Insurer's §524(g) End Game

Typically, a bankruptcy case will play out over approximately 18 to 24 months. An insurer should, throughout this period, focus on three main concerns. First, will the final reorganization plan's claim evidence criteria be comparable to the evidentiary and claim value safeguards and requirements that govern claim resolution under the terms of the insurance contracts in the tort system? Second, if the reorganization plan suspends the tort system's safeguards, will it also inflate claim settlement values and weaken proof standards? Third, is it better for an insurer to pursue its objections to a reorganization plan's claim evidence criteria in the bankruptcy case in bankruptcy court or through coverage litigation in a coverage litigation court?

Success will largely depend on what steps you take in the critical pre-bankruptcy time period and the opening days of the bankruptcy case.

As mentioned above, an insurer's end game is shaped by what it does well before a bankruptcy petition is filed and in the opening days of a new action. The remaining "plays" that finish the game—over the next 12 to 18 months—are the subject of another paper by the authors: *Lost in §524(g) Space: Asbestos Bankruptcies—The Survival Guide for the Voyage Back to Your Coverage Litigation*, also available from DRI.

The Insurer's Strategy Before a §524(g) Petition Is Filed

Bankruptcy is geared to provide rapid protection for the debtor. To protect its coverage defenses and options, an insurer must implement its strategy on "day one." What steps should an insurer take well before an insured files its bankruptcy petition?

Retain Bankruptcy Counsel Early

In some instances, coverage litigation will run parallel to a bankruptcy proceeding, in others, it will be stayed by the bankruptcy court. (See below.) The challenge, in both circumstances, is to do no harm to an insurer's strategies and affirmative defenses in either forum To best meet these challenges, insurers should select and consult

with bankruptcy counsel on an advisory basis as soon as it becomes apparent that an insured is considering filing a §524(g) petition. Bankruptcy counsel should be fully briefed on the pending coverage issues, disputes and litigation dynamics between an insurer client vis-à-vis other insurers involved in the coverage litigation and the insured. This step will ensure that coverage and bankruptcy counsel have a good grasp of the coverage litigation's substance and strategies on the date a bankruptcy petition is filed.

If a reorganization plan is confirmed, insurers will no longer be able to exercise the evidentiary and claim settlement value control granted under their insurance contracts and available in the tort system.

Use National and Local Insurer Bankruptcy Counsel

Bankruptcy laws, and the courts that administer them, have a specialized mission that uniquely challenges resolution of the coverage litigation issues that are sometimes entwined with a bankruptcy case. In addition to the Bankruptcy Code, bankruptcy cases are governed by the Federal Rules of Bankruptcy Procedure (F.R. Bankr. P.), which mirror the Federal Rules of Civil Procedure, with some variation, and relevant district court rules and general orders. Retaining national bankruptcy counsel makes good sense. It permits an insurer to (1) coordinate its various bankruptcy cases, (2) create consistent strategies and positions, (3) assure that counsel has accurate and complete institutional knowledge, and (4) foster trust between that counsel and key decision makers in the company.

As with all special forums, bankruptcy courts have their own particular local rules and general orders, and each bankruptcy judge has his or her own "local local rules." Thus, local bankruptcy counsel can be an invaluable asset in the fast-paced litigation that is the hallmark of bankruptcy cases. Note that rules imposed in some districts and circuits, or often by a given judge or panel, require that some provision be made to obtain the insight and experience that only local counsel can bring to the table. While bankruptcy law is federal, and therefore the same in all federal districts and circuits, bankruptcy counsel cannot automatically appear in any bankruptcy court, but must apply to appear *pro hac vice* if not admitted in a particular district. Some jurisdictions require local counsel be retained for each party.

Create a Joint Defense Group

All filings, discovery responses, declarations and statements to the court made by an insurer in a bankruptcy case may be argued to bind that carrier in coverage litigation. Therefore, the strategies advanced in a new bankruptcy case should be coordinated with those already in play in coverage litigation. One of the best ways to accomplish this goal is to form a coverage litigation joint defense group.

Typically, joint defense groups are formed first in coverage litigation to (1) simplify and streamline a case, (2) ease the burdens of proceedings on all parties and the court, and (3) coordinate discovery and motion practice. Joint defense groups organize the various coverage attorneys from all defendants into working groups aligned by strategies, issues, and affirmative defenses among certain insurers.

Expanding the joint defense group to include all bankruptcy counsel immediately protects an insurer's interests by creating a mechanism whereby all insurer positions and arguments can be vetted before they are presented in open court. This process minimizes unintended division among and collateral damage to various insurers. The groundwork for this step should have already been laid well before a bankruptcy petition is filed, to smoothly integrate national and local bankruptcy counsel into the coverage litigation joint defense group.

While it is important for an insurer to speak with one voice in a bankruptcy court, on occasion litigating coverage counsel simply have to address the court to clarify a point or forestall an unacceptable consequence for the coverage litigation. Thus, both coverage and bankruptcy counsel in the joint defense group should be admitted to appear in the bankruptcy court. Moreover, when bankruptcy counsel files pleadings in the case, your coverage counsel must be admitted to appear in that court if his or her name will appear on those pleadings.

The Opening Days of a §524(g) Bankruptcy

Take Immediate Control of all Paper

The blizzard of filings and service of documents in a bankruptcy case is much more intense than in a large, multiparty coverage case. In addition, the filing deadlines tend to be shorter than in state or federal court litigation. Therefore, immediate control of the bankruptcy paper is critical. It is advisable on "day one" to obtain copies of all items filed to date and to calendar hearing dates that have been placed on the bankruptcy court's "rocket" docket.

A debtor may request an order authorizing it to serve pleadings by e-mail or fax, instead of U.S. mail. Most bankruptcy courts have a mandatory electronic filing requirement and one program already in place is CM/ECF, which stands for Case Management/Electronic Court Filing, or ECF, for short. Bankruptcy and coverage counsel can register with a federal court program entitled Public Access to Court Electronic Records ("PACER"). PACER is used to review the docket sheet and download copies of pleadings. Some courts may have a general order that e-mail service of pleadings requires the recipients' written permission. The goal of these rules is to save trees and limit the inundation of paper on all recipients.

Some local rules require filing a courtesy paper copy of anything the court must review, with all exhibits tabbed. Even if not required, counsel are well-advised to provide such copies anyway, to ease a court's burden. It is also prudent to provide a judge's clerk with well-organized courtesy copies of all submissions as well. If they are voluminous, courts often appreciate receiv-

ing courtesy copies in a notebook format. As always, check the local rules.

The Chapter 11 Automatic Stay of Pending Actions

An automatic stay of all pending litigation is effective on the day that an insured files its Chapter 11 petition. *See* 11 U.S.C. §362(a). Generally, the automatic stay bars commencing or continuing an adversarial proceeding against the debtor, including any coverage litigation. Typically, a debtor will file a notice of the petition and of the automatic stay in the relevant trial courts on the day the petition is filed, serving all parties to those actions and all parties-in-interest. Coverage counsel should verify that the coverage litigation and pre-existing asbestos bodily injury actions his or her insurer is defending have in fact ceased. Moreover, coverage counsel should determine whether there are any direct action claims or suits pending against the relevant insurers, as these claims and suits may also be subject to the automatic stay.

Technically, §362(a) of the Bankruptcy Code prohibits any participation in, or continuation of the coverage litigation and any underlying asbestos claim defense litigation, where the action at issue was *brought against the debtor.* 11 U.S.C. §362(a). Application of the automatic stay to actions *brought by the debtor* is hotly debated. The best practice is to seek the bankruptcy court's approval for any act in any forum after a bankruptcy petition is filed. In the Ninth Circuit, for example, actions taken in violation of a §362(a) stay are void, not merely voidable. *Schwartz v. United States* (*In re Schwartz*), 954 F.2d 569, 571 (9th Cir. 1992). However, a coverage court *may* set a status conference after a bankruptcy petition is filed. Any appearances in or submissions made to a coverage court must be pre-approved by the bankruptcy court. Insurer counsel should nevertheless monitor debtor communications with the coverage court, should they occur despite the stay, to protect the insurer's interests.

The Removal of the Coverage Litigation to Bankruptcy Court

Pursuant to 28 U.S.C. §1452 (Removal of claims related to bankruptcy cases), an insured often elects to file a notice of removal of the coverage litigation pending in a state or district court. This notice automatically removes those actions to the bankruptcy court so that the debtor can avail itself of the §524(g) protections. *See* F.R. Bankr. P. 9027 (discussing removal procedures). Also, note that determination of a removed claim or cause of action requires the filing of an adversary proceeding. F.R. Bankr. P. 7001(10). This filing will cause the Bankruptcy Court to set a status conference for the removed actions.

The Insurers' Response to Removal is Due in 10 Days

At the very outset of a bankruptcy case an insurer must make a venue choice—whether to dispute the potentially objectionable proposed trust Scheduled Claim Values (payment amounts) and Trust Distribution Procedures (evidentiary criteria) in the bankruptcy or coverage litigation. Pursuant to F.R. Bankr. P. 9027(e), an insurer has 10 days from removal to file a statement with the bankruptcy court advising whether it consents or objects to the bankruptcy court presiding over the coverage litigation.

F.R. Bankr. P. 9027(e) requires that any party that has filed a pleading in connection with a removed cause of action also file a statement admitting or denying that the subject cause of action in the new proceeding is a "core" or "non-core" issue. *See* 26 U.S.C. §157(b)(2) (providing a non-exhaustive list of core issues considered within a bankruptcy court's jurisdiction). If an insured admits that the coverage litigation is non-core, it is not subject to bankruptcy jurisdiction.

Whether a Bankruptcy Court can preside over a coverage jury trial is a complex jurisdictional issue beyond the scope of this article.

The Remand of Litigation Back to the Coverage Court

Insurers must act immediately to coordinate opposition to removal, which usually involves a motion to remand the coverage litigation back to the court where it was pending before bankruptcy proceedings began. Because of the short deadlines relating to F.R. Bankr. P. 9027(e) procedures, a motion to remand the action back to the original coverage court requires a full strategic analysis well before an insurer faces these decisions.

The Insured's Attempts to Enjoin Remanded Litigation

In general, a bankruptcy court will not want to preside over coverage issues and will agree to remand an action back to the original court. However, the insured/debtor usually will not want its insurers to litigate coverage at the same time it is litigating the bankruptcy case. A insured/debtor will usually argue the costs, distractions, burdens and prejudice occasioned by a two-front war warrant an existing stay or an extended injunction against coverage litigation.

The loss of insurer control over its insured's claims is an inherent risk in a §524(g) bankruptcy.

However, there is, in fact, only one real strategic reason insureds seek a stay or an extended injunction; *i.e.*, to create the advantage in settlement negotiations that results when coverage issues remain on-hold and unresolved. Insureds seek further advantage by threatening to exclude insurers that do not settle before a reorganization plan is determined final by a court from the protection of the §524(g) channeling injunction. Only that injunction can cut off all contribution and direct action claims against a settled carrier. Whether a debtor can in fact exclude insurers settling after a reorganization plan becomes final from the class of parties protected by the plan's injunction is a hotly debated and unresolved issue.

A bankruptcy court may stay a remand order to stop coverage litigation from recommencing while a debtor develops a reorganization plan. 11 U.S.C. §105. If a dispositive motion in the coverage litigation is available, an insurer may alternatively seek a partial remand back to the original trial court for the purpose of advancing the motion. A bankruptcy judge may find this limited remand an attractive alternative to a complete stay of coverage litigation. A limited remand that permits a summary

adjudication motion ruling also impacts the dynamics of settlement negotiations, as one side or the other will have a clear signal of the risks and benefits of an agreement *versus* continued litigation.

The Debtor's "First Day" Motions

The debtor's initial filings will seek bankruptcy court approval to, among other things, (1) use cash collateral funds that are otherwise frozen; (2) consolidate two related bankruptcy cases; (3) approve pay for the debtor's officers, directors, and key employees; (4) fund ordinary course of business and necessary payables, such as utilities or critical vendors; or (5) pay professionals.

The blizzard of filings and service of documents in a bankruptcy case is much more intense than in a large, multiparty coverage case.

The grounds asserted to oppose a debtor's request to use funds, consolidate debtors, or pay expenses include misuse of claimant funds and inappropriate joinder of actions. An insurer's bankruptcy and coverage counsel should fully vet the decision to pursue objections to these largely administrative matters. It can be expected that a debtor will attack opposition to these motions aggressively, and this might not be the best fight to pick early in a bankruptcy case, depending on the circumstances.

The Claimant's Plan/Trust Representatives

The U.S. Trustee creates an official unsecured creditors committee ("UCC"), which generally consists of seven of the debtor's creditors with the largest claims, by dollar amount. In a §524(g) case, those seven creditors will most likely be groups of current asbestos claimants, *i.e.*, bodily injury plaintiffs in pre-bankruptcy defense actions. Usually, counsel for those plaintiff groups are the actual members of the UCC.

Pursuant to 11 U.S.C. §524(g)(4)(B)(i), a bankruptcy court will authorize the appointment of a future claims representative ("FCR") to represent the interests of unknown future claimants. The UCC and the FCR, together with their counsel, will be very involved in the bankruptcy case as it progresses. Assuming that the reorganization plan provides adequate debtor assets to pay future asbestos claims, the FCR will most likely be a proponent of the Chapter 11 reorganization plan that is ultimately developed and presented to the bankruptcy court and parties-in-interest.

The Professionals Retained by the Debtor, Unsecured Creditors Committee and the Future Claims Representative

The UCC, FCR and debtor, "with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title." 11 U.S.C. §327(a). If professionals are retained *without* court approval, they may not be entitled to compensation for their services.

In a §524(g) bankruptcy case, it is common for a debtor to employ, in addition to bankruptcy counsel, coverage counsel to continue to assist with coverage issues in the bankruptcy case, including the development of the reorganization plan. (See "Create a Bankruptcy Case Joint Defense Group," above.) Section 327(e) provides that, subject to court approval, a trustee, or debtor, "may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which the attorney is to be employed." 11 U.S.C. §327(e). The more stringent of the two analyses for conflicts of interest applies to professionals employed under §327(a) because of the "disinterestedness" requirement.

It is important to note that employment under §327(e) "may only be authorized for a 'specified special purpose' other than 'conducting the case.' The 'special purpose' must be unrelated to the debtor's reorganization and must be 'explicitly defined or described in the application seeking approval of the attorney's employment.'" *In re Running Horse, LLC*, 371 B.R. 446, 451 (Bankr. E.D. Cal. 2007) (citation omitted). *See also In Re Congoleum Corp.*, 426 F.3d 675, 691–92 (3d Cir. 2005) (reversing the bankruptcy court's appointment of special insurance counsel for the debtor pursuant to §327(e) and suggesting that the court should have questioned the post-petition role of the debtor's coverage counsel).

While proposed professionals are required to perform their own due diligence and conflict of interest checks before seeking employment, insurer coverage and bankruptcy counsel should independently consider whether there are grounds upon which to object to these retentions. Whether your adversary's counsel or its professional consultants has a conflict of interest is always an appropriate area of inquiry in any case. In some bankruptcy cases to date, employment of these law firms and professionals has been challenged based on an alleged conflict of interest, lack of experience or inability of the applicant to operate independent of and at arm's length from other parties in the case.

The Bar Date for Filing Claims

Pursuant to 11 U.S.C. §101(5), a claim is defined so that a creditor has the right to receive payment on a debt that was owed by the debtor on the date of the bankruptcy filing. The debtor will file a motion with the bankruptcy court for authority to establish certain deadlines for filing claims, which in bankruptcy parlance, is called a bar date, and certain procedures related to the form and content of claims. The debtor will file motions with the Bankruptcy Court that seeks entry of an order: (1) establishing bar dates for filing pre-petition claims; (2) approving proposed asbestos property damage claim form; (3) approving form and manner of notice of bar date for asbestos property damage claims; and (4) approving form and manner of notice of bar dates for other claims. The bar date is the last date for filing claims that arose before the date of the petition, *i.e.*, pre-petition claims. Proof of claims must be *received* by the bar date. You can obtain a conformed copy of the Proofs of Claim from the clerk's office and, now that most courts are com-

piling data electronically, you can check the claims register for the case through PACER and determine that your claim has been added to the claims register and assigned a claim number.

The claims bar date may not include the asbestos claims arising from alleged exposure to the debtor's products or operations in a §524(g) bankruptcy case, as those demands will be administered by the settlement trust. If, however, an insurer seeks creditor status and files a claim for reimbursement from the debtor for defense costs that the insurer incurred handling the underlying coverage litigation claims and/or pre-petition indemnity payments, then the bar date is applicable to these insurer claims. As noted, the debtor will fashion a claims filing procedure, set forth in its motion, and insurers should pay close attention to the nature of the claims that will or will not be filed, so that decisions can be made accordingly.

Claims are filed on a proof of claim form, or by a pleading that substantially complies with the form. Once a claim is filed, a claimant is deemed to have consented to the equitable jurisdiction of the bankruptcy court and *waived the right to a jury trial* regarding the issues set forth in the claim. *See Granfinanciera, S.A. v. Nordberg*, 109 S. Ct. 2782 (1989). Therefore, coverage and bankruptcy counsel should discuss whether it makes sense for their insurer client to file a claim as a creditor of the bankrupt estate or seek redress for defense and indemnity losses in coverage litigation. Depending on the nature of the claim, a creditor/insurer risks the bankruptcy court retaining jurisdiction to determine coverage issues pertaining to the creditor's claim, thus waiving any right to litigate the coverage issues.

The Insurer's §524(g) Discovery Opportunities

Because of the fast pace of a bankruptcy case, it is wise to make discovery of an insured's business history and financial affairs a priority in coverage litigation when faced with a potential petition filing. If an insured's business history discovery is not completed before a bankruptcy petition is filed, every effort should be made to finish that task once a petition is filed.

For example, insurer bankruptcy counsel will need to know the complete story about (1) the debtor's parent companies and successors, as well as related entities, and (2) the financial transactions between and among them. This information is critical should an insurer consider a settlement during the course of the bankruptcy case because it is important to know whether a debtor has related entities that might claim coverage under its policies. Likewise, the insurers' counsel should carefully consider whether valuable coverage litigation discovery may well be pursued in the bankruptcy case when issues in the two forums overlap.

The discovery rules in the F.R. Bankr. P. are somewhat similar, but not identical to, the Federal Rules of Civil Procedure and are also governed by local rules promulgated by the district in which the federal bankruptcy court is located. All rules that govern contested matters, including motions, must be followed when insurers seek information to support their positions. Because these rules differ from the more general federal rules of discovery, care should be taken to quickly and properly obtain evidence necessary for settlement analysis or to prevail on a given motion or strategic initiative.

The First Meeting of Creditors

Pursuant to 11 U.S.C. §341(a), the Office of the U.S. Trustee presides over what is known as the "341(a) hearing," which is technically a first meeting of creditors. All of the creditors receive notice of the date and time of the hearing. At the hearing, a staff attorney representing the U.S. Trustee will question the debtor's representatives under oath. A debtor may designate a "person most knowledgeable" to testify on its behalf. Generally, the president or CEO of the debtor entity testifies, and the testimony is audio recorded.

A debtor will file certain financial information with the U.S. Trustee thereafter on a monthly basis. Coverage or bankruptcy counsel should periodically review that information. For example, a debtor must provide accounting documents that show (1) cash received and cash distributions, and (2) salaries, bonuses, and other overhead items, including proof of current insurance, if the debtor owns real estate. It may be possible to arrange with the Office of the U.S. Trustee to review that information by e-mail.

The U.S. Trustee's representative will allow creditors or parties-in-interest to ask the debtor a few questions. The questions will elicit information about assets and liabilities and perhaps, assets transfers that appear on the debtor's schedules. However, the meeting is not intended to be a full-blown deposition or to take the place of discovery; it is intended to be a relatively short examination of the debtor. Therefore, an insurer's counsel or bankruptcy counsel should plan accordingly.

The Debtor's Schedule of Assets and Liabilities

Promptly after a bankruptcy petition is filed, a debtor is required to file schedules of assets and liabilities, a detailed list of its creditors, and a statement of financial affairs, which, among other things, identifies (1) all pending litigation in which the debtor is involved, (2) related or affiliated entities, (3) actual or potential co-obligors for claims, (4) general unsecured creditors and secured creditors, (5) bank and other account balances, (6) tax obligations, (7) real estate holdings, and (8) assets transferred to and from the debtor within various statutory time periods prior to filing for bankruptcy (collectively referred to as the bankruptcy schedules). F.R. Bankr. P. 1007. As insurers review the initial bankruptcy schedules, they should remember that those and other like filings may be, and usually are, amended from time to time.

The Debtor's Disclosure Statement

Pursuant to 11 U.S.C. §1125, a debtor is required to draft and serve a proposed disclosure statement. A debtor's goal is to obtain an order from the bankruptcy court approving the disclosure statement. The ultimate purpose of the disclosure statement is to provide the creditors who will vote on the proposed reorganization plan with sufficient information to decide how to vote. In a §524(g) bankruptcy, as noted above, it is the asbestos bodily injury claimants and plaintiffs who must approve the reorganization plan with a 75 percent super majority "yes" vote. This single aspect of §524(g) procedure ensures that these parties, more than any other, dominate setting the reorganization plan's trust settlement payment amounts and claim evidence criteria. There can be no final plan with-

out this constituency's approving vote. In short, the claimants/plaintiffs determine in large measure the standards of proof they themselves must meet to receive a settlement and the amount/value of that payment. Thus, in turn, it is their lawyers who dominate the reorganization plan/settlement trust drafting process because they control the UCC.

Insurers must act immediately to coordinate opposition to removal, which usually involves a motion to remand the coverage litigation back to the court where it was pending before bankruptcy proceedings began.

Moreover, an insurer's ability to alter the trust's Scheduled Claim Values and TDPs is limited. The insurers, generally appearing as *parties-in-interest*, rather than *creditors*, are often argued by the debtor to have no standing to object to the proposed proof criteria and claim values. If they adopt the status of a creditor to gain standing to object to the criteria and values, they waive their right to a jury trial and accept the jurisdiction of the bankruptcy court for applicable coverage litigation.

Whether a debtor's standing argument succeeds or not, the best venue for insurers with party-in-interest status to directly affect a settlement trust's claim evidence criteria and payment values may well be in the state or federal coverage case, where there is ample time for discovery, case development and motion practice. While theoretically all that discovery may be accomplished in a bankruptcy court, the time allotted will only be days and weeks, as opposed to the months and several years often required and permitted in complex, multiparty coverage litigation to build a successful case. While discovery will be conducted in connection with the feasibility of the terms and the conditions of the reorganization plan prior to the confirmation hearing, that discovery will be limited in scope and time, even if an insurer successfully asserts standing to seek it. Moreover, while an insurer's objections to a settlement trust's claim criteria and settlement payment amounts can be made informally, and attempts to do so have been successful in some cases, this is an indirect and difficult strategy if you expect to achieve satisfactory results.

The Remaining Steps of a §524(g) Bankruptcy

The bankruptcy case will proceed for another 12 to 18 months after the first critical stages of this litigation discussed above. We briefly summarize in this section the major steps to be taken by an insured/debtor and its insurers in the remaining months of a bankruptcy case.

The Insurer's Motion to Appoint a Chapter 11 Trustee

When a debtor files its bankruptcy petition it becomes a debtor-in-possession, *i.e.*, it is in possession of the estate that is created by the filing of the petition, which leaves the debtor in possession, control and management of the estate. Pursuant to 11 U.S.C. §1104, insurers or creditors may file a motion to appoint a Chapter 11 trustee to replace the debtor-in-possession. A Chapter 11 trustee is a fiduciary to the creditors and his or her goal is to maximize the value of the estate for the benefit of all creditors. A trustee motion can allege that under the debtor's management, the debtor (or the professionals it retained): (1) held interests adverse to the estate, (2) acted contrary to the debtor's fiduciary duties to the estate, or grossly mismanaged it, or (3) in an insurance case, failed in its duty to cooperate with the debtor's insurers under its insurance policies.

The Debtor's Plan of Reorganization

Confirmation of a plan of reorganization requires, among other things, that the plan "has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. §1129(a)(3). The reorganization plan controls payment of asbestos bodily injury claims, generally organized into disease categories, which determine the compensation for claims based on the qualifying disease.

The Plan's Scheduled Claim Values

The typical disease claim categories in asbestos litigation are mesothelioma, lung cancer, other cancers, asbestosis, and pleural plaques. The disclosure statement and the reorganization plan will typically assign a set payment figure—generally referred to as the Scheduled Claim Value—for each category of disease for which a claim is made. The factual bases for the calculations that result in the Scheduled Claim Values in a given plan administered by a settlement trust are always hotly debated. Since a trust will generally settle rather than litigate a given claim, historic settlement values—as opposed to judgments—drive the valuation analysis. Although judgments are not ignored, the extent of their role in establishing the Scheduled Claim Value amounts is a disputed and critical issue. Inflation of claim settlement values by a plan that is in fact controlled by the UCC—the claimants themselves—opens the door to "extra-contractual protections;" *i.e.*, claim values well beyond those available to claimants when losses are resolved under the policy and in the tort system.

A reorganization plan usually creates a chart that sets forth all the Scheduled Claim Value payment amounts in a matrix (sometimes called the "Matrix Values").

The Plan's Trust Distribution Procedures

Ensuring that the reorganization plan has appropriate but rigorous claim proof criteria is as important as fixing the correct Scheduled Claim Values. The plan will set forth the procedural and evidentiary claim filing rules for trust claimants. The requisite evidence will need to establish (1) exposure to the debtor's asbestos products or operations and (2) that an asbestos-related disease has resulted from that exposure. These procedures and evidence criteria are generally referred to as Trust Distribution Procedures or TDPs. Over the last 25 years of asbestos bodily injury tort litigation, basic standards have evolved for asbestos exposure and medical causation evidence that are sufficient to support a finding of

liability for each category of disease Claimants do not generally obtain settlements or judgments in the tort system unless they present proof (1) of exposure to the policyholder's product or operations, (2) of the frequency and duration of that exposure, or (3) to a reasonable medical certainty that an asbestos-related bodily injury did result from that exposure.

If the quality of medical and exposure proof required in the tort system is not reflected in a reorganization plan's TDPs, then claims that historically would not have been paid under the policy and in the tort system will be honored by the trust. This results in "extra-contractual protections" being afforded an insured and its claimants.

The Plan's Insurance Neutrality Provisions

The disputes over a reorganization plan's Scheduled Claim Values and TDPs often result in an insurer's demand for a so-called insurance neutrality provision in the plan. This provision generally provides, with certain exceptions, that if an insurer receives a tender of defense or demand for indemnity from the §524(g) trust under its insurance policies, but wishes to contest the applicability of coverage, those disputes will be resolved subject to any and all insurance coverage defenses through coverage litigation *and not* through the bankruptcy case. The typical exceptions in these provisions to the defenses otherwise reserved to insurers and preserved under a reorganization plan are as follows: (1) the transfer of the debtor's insurance rights to the trust pursuant to the plan; (2) any defense that has been released by any other settlement between the Debtor and an insurer; (3) defenses that are being litigated by the insurers in the bankruptcy case; and (4) any defense premised on an argument that commencing the bankruptcy proceedings violated a provision of an insurance policy.

Bankruptcy courts will generally rely on insurance neutrality provisions to resolve objections to a reorganization plan filed by a party-in-interest-insurer—as opposed to a creditor-insurer. Disputes over the risk of "extra-contractual protections" being afforded an insured and its claimants are the prime reason for the emergence of insurance neutrality provisions in most plans. These provisions permit an insurer to resolve its objections to payment values and evidentiary criteria in its coverage action. Therefore, insurers must be vigilant about scrutinizing the scope, wording and exceptions stated in any proposed insurance neutrality provision to carefully chose their remedies and forums.

The Motions to Approve Insurers' Settlements (Pre- or Post-Petition)

Insurer'settlements generally make up the bulk of the funding for a §524(g) trust. Settling insurers receive the benefits of the §524(g) injunction described above. Those insurers who do not settle do not receive the benefit of the injunction and, therefore, the debtor retains its rights against those insurers and coverage litigation between them will continue. The settlements may include a sale by a debtor and a purchase by an insurer of the policy, often referred to as a policy buy back. If a debtor sells an asset, such as an insurance policy, outside of the ordinary course of business, the sale is governed by 11 U.S.C. §363. Whether or not a bankruptcy petition is being considered by a given insured, when an insurer settles a coverage dispute pre-petition it is wise to add an agreement provision that requires the insured to include the insurer in any injunction that may someday issue.

There are certain incentives to both a debtor and the insurers to consider settling coverage issues before the reorganization plan is confirmed. Generally, a debtor may seek to settle with as many of the insurers prior to a plan's confirmation to acquire insurance settlement proceeds to fund the plan's trust. Alternatively, settling insurers may want to resolve coverage litigation before a plan is confirmed so that as settling insures they thereby receive the protections of a §524(g) channeling injunction. Most important, insurers can structure their settlements to limit or "cap" their exposure to settlements controlled by the claimants via the plan's claim proof criteria and settlement values.

Conclusion

When an insured petitions for a §524(g) bankruptcy, its insurers will immediately find themselves litigating their coverage defenses in two forums. Will that insurer contest a reorganization plan's trust claim settlement payment amounts and evidence criteria in the bankruptcy proceedings or in the coverage litigation? The end game for insureds is to obtain the support of its claimants for a §524(g) bankruptcy plan. This "political reality" raises the specter of "extra-contractual protections" being afforded those same claimants via Scheduled Claim Values and TDPs that can provide recoveries not available under the insurance contract or in the tort system. Thus, preparation of an insurer's end game in fact begins at the outset of coverage litigation, well before a §524(g) petition is even considered. It is then that insurers must exercise firm control over the defense of asbestos claims to ensure that any future plan's Schedule Claim Values and TDPs are consistent with their contracts of insurance and the protections afforded by the tort system. At this same moment in time, insurers should begin to prepare the parallel coverage and bankruptcy litigation strategies that must be in play the very first day their insured seeks the benefits of a §524(g) bankruptcy plan. Keeping this field guide at hand will help insurance professionals, in-house counsel or private practice litigators fashion successful strategies to meet an asbestos claim plagued insured's almost inevitable §524(g) petition. FD