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Feature

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Ninth Circuit Reverses § 524(g) Plan Confirmation, Upholds Injunction of Insurer Contribution Rights

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In *Fireman's Fund Insurance Company v. Plant Insulation Co. (In re Plant Insulation Co.)*, the Ninth Circuit Court of Appeals struck down the § 524(g) reorganization plan of Plant Insulation Company.[1] The decision reversed the confirmation order on the basis that the plan failed to satisfy provisions of 11 U.S.C. § 524(g) requiring that an asbestos trust have the ability to take control of the reorganized debtor under certain circumstances.

While the court of appeals' decision to reverse the confirmation order was based upon the trust-ownership issue, the issue that will likely generate greater debate going forward is the court's ruling on the scope of permissible nondebtor injunctive relief. Specifically, the panel ruled that § 524(g) authorizes an injunction cutting off the valuable-contribution rights of nonsettling insurers against settling insurers without fully compensating the nonsettling insurers for the loss of their legal rights if doing so is "fair and equitable" from the perspective of future claimants.

Underlying Facts

Plant Insulation, a former seller and installer of insulation products that contained asbestos, ceased operations in 2001 when it transferred its insulation and repair business to Bayside Insulation & Construction, Inc., formed by Plant Insulation's 49 percent owner. By January 2006, more than 3,800 asbestos claims had been filed against Plant Insulation, and in September 2006, the asbestos claimants formed an informal committee. To seek confirmation of a § 524(g) plan, the committee concluded that Plant Insulation would need to be resurrected from a dormant shell into an ongoing business. The committee notified Bayside that it considered Bayside to be liable for the debts of Plant Insulation under theories of successor liability, and in early 2010, Bayside agreed to a plan to merge with Plant Insulation.

Plant Insulation's Bankruptcy Filing and Proposed Plan

Plant Insulation's only meaningful assets were (1) cash settlements from certain insurers that had previously repurchased their policies from Plant Insulation and (2) disputed coverage obligations of other insurers that were the subject of ongoing coverage litigation in California state court. Plant Insulation's plan provided for the establishment of a § 524(g) asbestos trust. Under the plan, the trust was to be funded almost entirely by $131.5 million from insurer settlements to be used for the payment of current and future asbestos personal-injury claims, and the asbestos claimants could seek recovery from the trust and would be paid out based on factors unique to their specific claims.

The trust would also own 40 percent of the equity in the reorganized debtor after it merged with Bayside.[2] To obtain its equity interest in Bayside, the trust was required to invest $2 million for a 40 percent interest in the company. Further, the trust would receive a warrant to purchase an additional 11 percent of Bayside, as well as a $250,000 promissory note from Bayside, secured by the shares of other shareholders. Additionally, the trust would make a five-year revolving loan to Bayside in the amount of $1 million. Bayside also had an option to

1 734 F.3d 900 (9th Cir. Oct. 28, 2013).

2 *Id.* at 907.

repurchase the trust's shares at any time for their purchase price, plus 10 percent simple interest.[3]

The plan also provided that the asbestos claimants could assert a claim against the trust *and* pursue claims against Plant Insulation/Bayside in the tort system, with any suits against Plant Insulation/Bayside to be tendered to the nonsettling insurers. Accordingly, instead of completely enjoining the claimants' suits through a channeling injunction, the asbestos claimants' tort claims could proceed, subject to certain limitations. Plant Insulation referred to this novel arrangement as an "open system."[4]

In addition to the traditional channeling injunction directing claims of current and future claimants to the trust, the plan contained a "settling-insurer injunction" barring nonsettling insurers from asserting equitable contribution claims against the settling insurers, notwithstanding that such claims are permitted pursuant to applicable nonbankruptcy law. The settling-insurer injunction provided that the settling insurers would not be subjected to any liability arising out of suits brought pursuant to the "open system," including equitable-contribution claims by nonsettling insurers. The plan provided nonsettling insurers with limited protections. Specifically, any judgment against a nonsettling insurer was to be reduced by any amount previously paid to the claimant by the trust. Additionally, such judgment was subject to further reduction, equivalent to the value of any equitable contribution claim that a nonsettling insurer would have had against any settling insurer. Finally, the plan provided no redress for equitable-contribution claims arising from asbestos claims that were defended, but ultimately dismissed or settled without any resulting adverse judgment.[5] The bankruptcy court overruled the nonsettling insurers' objections, the district court affirmed confirmation, and the nonsettling insurers appealed.

The Ninth Circuit's Decision

As the Ninth Circuit observed, "[a]part from the presence of asbestos liability, Plant's situation could hardly be more different than Johns-Manville's situation,"[6] which involved the reorganization of an otherwise-thriving company beset by massive asbestos liabilities, upon which § 524(g) was modeled. "As a result, the plan in this case is entirely different from the Johns-Manville plan … [and t]he questions before us today essentially boil down to whether this arrangement passes muster."[7] Among the discrete issues addressed by the court of appeals were (1) whether the contingencies for the trust's taking control of Bayside were illusory and inadequate to satisfy the statutory requirements, and, therefore, violated § 524(g); and (2) whether the settling insurer injunction's extinguishment of the settling insurers's equitable-contribution claims without full compensation violated the provisions of § 524(g) or was otherwise impermissible.

Analysis of the Settling Insurer Injunction

Plant Insulation's plan permitted claimants to continue to pursue claims against Plant Insulation in the tort system, with such suits being tendered to the nonsettling insurers for defense and indemnity, but the plan's "settling-insurer injunction" cut off the nonsettling insurers' California law equitable-contribution claims against the settling insurers to recover their fair share of the defense and settlement payments made by the nonsettling insurers. The plan provided judgment-reduction credits to the nonsettling insurers for the amount of their equitable-contribution claims against the settling insurers, but only in those situations where the nonsettling insurer litigated a tort system claim to final judgment. For claims that were settled or dismissed — and the Ninth Circuit recognized the reality that substantial numbers of asbestos claims in the tort system are settled or otherwise disposed of prior to judgment — the nonsettling insurers would receive no credit at all, but would still be enjoined from pursuing equitable-contribution claims against the settling insurers.[8]

The nonsettling insurers argued that § 524(g) does not authorize an injunction of insurer vs. insurer contribution claims because such claims "are not to be paid 'in whole or in part' by the Trust because they are not claims against the debtor[, but rather] are claims against other insurance companies."[9] The court parsed the language of § 524(g)(1)(B), noting that it authorizes an injunction "to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust."[10] Although acknowledging that this provision is "far from clear," the court equated the phrase "with respect to" to "relating to" and declared that "it is eminently reasonable to paraphrase the statute as follows: 'an injunction may be issued to enjoin entities from taking legal action for the purpose of collecting any payment related to a claim or demand that is to be paid in whole or in part by the trust.'"[11] Moreover, the court opined, "equitable contribution claims are, themselves, components of asbestos claims, which are the kind of claim that the trust does pay," albeit "formally" brought against different parties. Equitable-contribution claims, the court concluded, "are 'legal action for the purpose' of recovering 'with respect to' asbestos claims," and therefore may be enjoined as against settling insurers under the terms of § 524(g)(1)(B) and (g)(4)(A)(ii)(III).[12]

Having concluded that such an injunction is statutorily permissible, the court proceeded to consider whether the injunction was otherwise impermissible, since "[t]he parties generally agree that the Non-Settling Insurers lose some valuable rights without full compensation," and the nonsettling insurers argued that "principles of equity demand full compensation for their loss of rights." The nonsettling insurers placed principal reliance on the Sixth Circuit's decision *In re Dow Corning Corp.*[13] and the six so-called "*Dow Corning* factors," two of which require full compensation for the loss of a nondebtor's rights to make claims against another nondebtor.

3 *Id.*
4 *Id.*
5 The court of appeals acknowledged that the nonsettling insurers' contribution claims were "'valuable' and 'generally enforced.'" *Id.* at 909.
6 *Id.* at 906.
7 *Id.*
8 *Id.* at 912-13.
9 *Id.* at 910.
10 *Id.*
11 *Id.*
12 *Id.* at 910-11.
13 280 F.3d 648 (6th Cir. 2002).

The court distinguished *Dow Corning* on the grounds that that case did not involve asbestos or § 524(g) injunctions. Section 524(g), the court continued, specifically contemplates such injunctions and instructs that their enforceability must be measured from the standpoint of whether such injunctions are "fair and equitable with respect to [future claimants], in light of the benefits provided, or to be provided to the trust on behalf of [a party protected by the injunction]."[14] By "enacting this subsection," the court continued, "Congress articulated a clearer standard for weighing the equities in the context of an asbestos-related bankruptcy."[15] Under § 524(g), the court opined, "the two classes of persons whose interests the courts must attentively evaluate before issuing an injunction" are future asbestos claimants and nondebtor injunction beneficiaries, such as settling insurers.

> In other words, before it may issue an injunction under § 524(g), a court must ensure that the remedy be "fair and equitable" to future asbestos plaintiffs (the parties to be enjoined) when viewed in comparison to the benefits provided by the bankrupt and its insurers (the parties to be benefitted by the injunction).
>
> Section 524(g), unlike the general provision of § 105(a), gives the bankruptcy courts more detailed guidance in the exercise of their equitable powers. In crafting these more specific instructions, Congress has not commanded that the interests of other third parties, such as the Non-Settling Insurers in this case, enter into the calculus.[16]

Having interpreted § 524(g) as displacing generally applicable equitable principles requiring consideration of the fairness of the proposed injunction to the enjoined (and here, undercompensated) parties, the court upheld the settling-insurer injunction based on the bankruptcy court's determination that such an injunction was "fair and equitable" to the future claimants and provided "the necessary incentive for the insurers to settle in the first place."[17] Moreover, the court found that the bankruptcy and district courts "conscientiously accounted for the rights of Non-Settling Insurers whose interests the statute did not explicitly direct them to take cognizance."[18] Accordingly, the court concluded that the channeling injunction sufficiently satisfied the statutory scheme.

Court's Analysis of Trust Ownership Issues

While the court seemed to view compliance with the "ongoing entity" requirement as more of a technical requirement that was necessary to permit the trust to receive more than $100 million "of settlement proceeds [that] are what is really 'funding' the trust," the Ninth Circuit agreed that the plan failed to satisfy § 524(g)'s requirement that the trust have the ability to control Bayside "if specified contingencies occur."[19] The bankruptcy court found that this requirement was satisfied by the trust's ability to exercise its outstanding warrant to purchase an additional 11 percent of Bayside's shares, as well as by the trust's right to take control of a controlling stake in Bayside should Bayside default on the $250,000 note. Adopting the reasoning of the bankruptcy court in *In re Congoleum Corp.*[20] that emphasized the need under § 524(g)'s statutory scheme for the trust to control an ongoing business, the court found that a contingency that would permit the trust to take control of Bayside was, as the nonsettling insurers had contended,"illusory."[21]

If any "contingency" were acceptable, the "specified contingencies" provision could be rendered a nullity through clever plan draftsmanship ("such as a meteor hitting the Empire State Building"). Therefore, the court continued, "specified contingencies" must be "regulated by the bankruptcy court to ensure that control is either a realistic possibility or a backstop to trust insufficiency," but "cannot be 'shams' that allow control facially, but not in practice."[22] The court reversed the confirmation order on this ground and remanded the case for further proceedings.

While the court of appeals technically reversed the confirmation order, it did so on the narrowest of grounds while providing the parties (and the courts below) with a roadmap for how an amended plan may be approved. Overall, the Ninth Circuit's decision seems to indicate at least judicial tolerance for "Lazarus" § 524(g) plans, bearing little resemblance to the *Johns-Manville* model, that "reanimate" defunct companies to permit them to qualify to obtain § 524(g) channeling-injunction protection. While the value of the reorganized debtor was negligible compared to insurer contributions to the trust, the court required, pursuant to § 524(g), that a viable reorganized debtor exist to provide some source of "evergreen" funding for the trust and that the trust either control or have meaningful right to obtain control over that entity.

The ultimate takeaway from this decision appears to lie not with the issue that was the basis for reversal but with the court's approval of the settling insurer injunction's treatment of the nonsettling insurers' equitable contribution rights by interpreting the provisions of § 524(g) to deny the nonsettling insurers the rights and considerations to which they would have otherwise been entitled under applicable nonbankruptcy law. In so doing, the court relied on admittedly elusive "legislative intent" and the general "statutory scheme" rather than the actual statutory text.

Section 524(g) authorizes injunctions to "supplement the injunctive effect of a discharge under this section [524]." Section 524(a) discharges claims against the debtor, not claims by nondebtors against nondebtors. It is those claims (and future demands) that are channeled to a trust, and it is the pursuit of those claims and demands against specified classes of nondebtors that may be enjoined under § 524(g). This is confirmed — not negated, as the Ninth Circuit seemed to believe — by the language of § 524(g)(1)(B), which only permits an injunction of a "claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust." In this case, none of the nonsettling insurers' equitable-contribution claims were to be paid "in whole or in part by a trust." Such claims were not channeled to the trust for partial payment by a traditional § 524(g) injunction, but instead were entirely enjoined out of existence by a dis-

14 734 F.3d 900; *In re Plant Insulation*, 734 F.3d at 912.
15 *Id.*
16 *Id.*
17 *Id.* at 913.
18 *Id.*
19 *Id.* at 916-17.
20 362 B.R. 167, 176 (Bankr. D.N.J. 2007).
21 *In re Plant Insulation*, 734 F.3d at 915.
22 *Id.* at 916.

tinct "settling-insurer injunction." By equating "with respect to" to "relating to," the court ignored the crucial distinction between "supplementing" the discharge injunction to extend protection to third parties from claims against the estate as opposed to enjoining a new class of claims exclusively among nondebtors because such claims bear some "relation to" the asbestos claimants' claims against the debtor. In so doing, the court ignored the plain language of § 524(g).

Section 524(g) grants substantial due-process protections to claimants whose claims are to be channeled and enjoined. These due-process safeguards, as well as others, should be extended to entities, such as the nonsettling insurers, that have no claims against the debtors (and whose equitable-contribution claims arose only because Plant Insulation's plan, uniquely, permitted the continued pursuit of claims against Plant Insulation in the tort system). Based on the language of § 524(g) and existing circuit court precedent outside the asbestos context, the court should have concluded that noncreditors of the estate whose rights were being impaired by the plan were entitled to as much due process as the asbestos claimants themselves. Instead, the court reversed the confirmation order on a narrower ground while recommending how a similar plan could be confirmed. **abi**

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