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# Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies

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# OVERLOOKING TORT CLAIMANTS' BEST INTERESTS: NON-DEBTOR RELEASES IN ASBESTOS BANKRUPTCIES

Joshua M. Silverstein \*

*The asbestos crisis has spawned the development of extraordinary new remedies. One of the most dramatic and controversial is known as a “non-debtor release,” a bankruptcy order extinguishing claims against a party who has not itself filed for bankruptcy. Also known as a “third-party release,” this form of relief first found acceptance in early asbestos insolvencies. Since that time, Congress has passed a statute—§ 524(g) of the Bankruptcy Code—that expressly authorizes non-debtor releases in asbestos reorganizations. Powerful remedies are subject to abuse, and third-party releases are no exception. In this article, I argue that bankruptcy courts and litigants have overlooked critical limits on non-debtor releases—limits contained in both § 524(g) and other provisions of the Code. The most important restriction is this: Under the best interest of creditors test set forth in § 1129(a)(7) of the Code, it is permissible to extinguish the liabilities of a third party over the objection of claimants only when the plan of reorganization promises payment in full on the released claims.*

I.	INTRODUCTION .....	2
II.	THE ASBESTOS TORT LITIGATION .....	7
III.	THE JOHNS-MANVILLE BANKRUPTCY .....	10
	A. Pre-confirmation Proceedings .....	10
	B. The Plan of Reorganization.....	12
	1. The Litigation Trusts.....	12
	2. The Channeling Injunction.....	14
	3. Plan Approval and Confirmation .....	15
	C. The MacArthur Insurance Litigation .....	16
IV.	NON-DEBTOR RELEASES AFTER THE MANVILLE BANKRUPTCY .....	19
	A. Non-Debtor Releases in General.....	20
	1. Non-Debtor Releases Defined.....	20
	2. The Circuit Split Regarding the Legal Validity of Non-Debtor Releases .....	22
	3. Distinguishing Non-Debtor Releases from Other Types of Relief.....	28
	B. Non-Debtor Releases Involving Insurance .....	31
	1. The Non-Bankruptcy Rights of Co-Insureds and Tort Claimants in a Debtor’s Insurance Policy .....	31
	2. Insurance Policies and Proceeds in Bankruptcy.....	46

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V.	SECTION 524(g) OF THE BANKRUPTCY CODE.....	55
	A. The Purpose and General Structure of Section 524(g).....	55
	B. The Requirements for a Supplemental Injunction Protecting the Debtor .....	57
	C. Section 524(g)'s Additional Requirements When The Injunction Protects Non-Debtors .....	61
VI.	LIMITATIONS ON ASBESTOS NON-DEBTOR RELEASES .....	66
	A. The Varying Scope of Asbestos Non-Debtor Releases.....	66
	B. Asbestos Non-Debtor Releases Issued Under §§ 105(a) and 1123(b)(6).....	68
	C. Asbestos Non-Debtor Releases Issued Under § 524(g) .....	71
	1. The Relationship of § 524(g) to General Non-Debtor Release Law .....	70
	2. Counterarguments Regarding the Payment-In-Full Requirement .....	83
	3. Asbestos Non-Debtor Releases and the Fair-and-Equitable Standard .....	93
VII.	CONCLUSION .....	99

“A strong disease requyreth a stronge medicine.”<sup>1</sup>

## I. INTRODUCTION

The asbestos crisis has bedeviled our legal system for over thirty years. It is now the “longest-running mass tort litigation in U.S. history.”<sup>2</sup> The “avalanche of asbestos lawsuits” has overwhelmed the civil courts.<sup>3</sup> More than seventy firms have declared bankruptcy as a result of asbestos liability.<sup>4</sup> Countless plaintiffs have been denied full compensation on their claims.<sup>5</sup> And courts and legislatures have been unable to develop a comprehensive answer to the problem.

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<sup>1</sup> DESIDERIUS ERASMUS, PROVERBS OR ADAGIES WITH NEWE ADDICIONS GATHERED OUT OF THE CHILIADES OF ERASMUS (photo. reprint 1969) (1539).

<sup>2</sup> STEPHEN J. CARROLL ET AL., RAND INST. FOR CIVIL JUSTICE, ASBESTOS LITIGATION vii (2005), available at <http://www.rand.org/pubs/monographs/MG162/> [hereinafter RAND]. The RAND report is a truly outstanding document. I recommend it to anyone interested in asbestos litigation, specifically, and mass tort litigation, generally.

<sup>3</sup> See *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 200 (3d Cir. 2004) (“For decades, the state and federal judicial systems have struggled with an avalanche of asbestos lawsuits.”).

<sup>4</sup> See RAND, *supra* note 2, at 109-10 (estimating that seventy-three asbestos defendants have filed for bankruptcy through the summer of 2004); *id.* at 152-53 (listing the seventy-three companies); Martha Neil, *Backing Away from the Abyss: Courts May Be Starting to Get a Grip on Asbestos Litigation*, 92 A.B.A. J., Sept. 2006, at 26, 29 (“To date, an estimated [eighty-five] companies have filed for bankruptcy claiming asbestos liabilities as the cause.”).

<sup>5</sup> See RAND, *supra* note 2, at 114-15 (noting that many bankrupt asbestos defendants have not been able to pay asbestos plaintiffs in full through their reorganizations). For more on this point, see *infra* notes 469-72 and accompanying text.

Although a global resolution remains out of reach, experimentation with piecemeal remedies has proceeded since the early stages of the litigation. Courts have developed new procedures to deal with the size and complexity of asbestos cases. Moreover, legislatures have enacted a range of statutes to address various aspects of the asbestos quandary.

One of the most dramatic remedies to emerge from the crisis is known as a “non-debtor release.”<sup>6</sup> Similar in effect to the discharge granted to bankrupt debtors,<sup>7</sup> a non-debtor release is a bankruptcy order extinguishing the liabilities of a party who has not itself filed for bankruptcy.<sup>8</sup> Also known as a “third-party release,” such a release is typically justified on the ground that the benefiting non-debtor is making a financial contribution to the debtor’s estate—a contribution that is necessary for the success of the debtor’s reorganization.<sup>9</sup>

Non-debtor releases first received judicial approval in the reorganization of the Johns-Manville Corporation, one of the earliest asbestos insolvencies brought under Chapter 11 of the Bankruptcy Code.<sup>10</sup> The Manville case lent considerable legitimacy to third-party releases.<sup>11</sup> Shortly thereafter, increasing numbers of debtors began adding such provisions to their plans of reorganization, including parties driven into bankruptcy as a result of non-asbestos liabilities.<sup>12</sup> And many courts granted the requested relief, generally finding the authority to issue third-party releases in § 105(a) of the Code,<sup>13</sup> the primary source of the bankruptcy courts’ general equitable powers. However, other courts adopted a contrary view, typically ruling that non-debtor releases are prohibited by § 524(e) of the Code; that statute provides that discharging the debtor from a debt does not impact any liability of a third party for the discharged debt.<sup>14</sup>

The legality of third-party releases remains controversial in non-asbestos cases,<sup>15</sup> but their legitimacy in the asbestos context is now well established. In 1994, Congress added § 524(g)<sup>16</sup> to the Bankruptcy Code.<sup>17</sup> This statute grants

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<sup>6</sup> See *In re Transit Group, Inc.*, 286 B.R. 811, 820 (Bankr. M.D. Fla. 2002) (“Non-debtor releases are extraordinary and should be reserved for unusual circumstances.”); Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate Over Non-Debtor Releases in Chapter 11 Reorganizations*, 23 EMORY BANKR. DEV. J. 13, 68 (2006) (explaining that non-debtor releases “are a drastic form of relief”) (internal quotation marks omitted).

<sup>7</sup> See generally 11 U.S.C. §§ 523-24, 727, 944, 1141(d), 1328 (2006).

<sup>8</sup> See *infra* Part IV.A.1.

<sup>9</sup> See, e.g., *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 938 (Bankr. W.D. Mo. 1994) (finding that without a release, the non-debtors would not have made contributions that enabled the debtor to formulate a workable plan and allowed creditors to recover in full).

<sup>10</sup> See RAND, *supra* note 2, at 110-11.

<sup>11</sup> The Manville bankruptcy is discussed in Part III, *infra*.

<sup>12</sup> See, e.g., *In re A.H. Robins Co., Inc.*, 88 B.R. 742, 754-55 (E.D. Va. 1988) (mass tort case involving the Dalkon Shield holding that courts may grant non-debtor releases pursuant to their “equitable and inherent” power under the Bankruptcy Code), *aff’d*, 880 F.2d 694 (4th Cir. 1989).

<sup>13</sup> 11 U.S.C. § 105(a) (2006).

<sup>14</sup> *Id.* § 524(e).

<sup>15</sup> See *infra* Part IV.A.2 (summarizing the split in the courts); Part IV.B (addressing some special features of the split concerning insurance).

<sup>16</sup> 11 U.S.C. § 524(g) (2006).

courts extensive additional powers in reorganizations initiated by debtors because of asbestos liabilities.<sup>18</sup> Included in the list of powers is the authority to grant a non-debtor release to certain parties related to the debtor who are alleged to be responsible for the debtor's asbestos obligations.<sup>19</sup>

Since the adoption of § 524(g), numerous courts have issued third-party releases in asbestos cases.<sup>20</sup> But many of these courts have cited both § 524(g) and § 105(a) as authority for such releases, perhaps because the precise scope of § 524(g) is unclear, creating a danger that a given release falls beyond its scope.<sup>21</sup>

In this article, I contend that critical limitations on non-debtor releases, whether the release is granted under § 524(g) or § 105(a), are not being addressed by the courts in asbestos bankruptcies. The most important of these limitations is that, under the best interests of creditors test,<sup>22</sup> it is only permissible to extinguish the liabilities of a third party over the objection of claimants when the plan of reorganization promises payment in full on the released claims. Because so few judicial opinions confirming reorganization plans in asbestos insolvencies have considered this requirement, numerous tort plaintiffs have been deprived of an alternative source of compensation without receiving the mandated assurance of full payment.

One reason that courts are overlooking applicable safeguards may be that asbestos claimants are not fully aware of such protections, and thus they are waiving their rights, either by voting for the plan, or by failing to object to confirmation. If so, this article is all the more necessary because it will serve to educate both courts and litigants about the legal principles that govern asbestos non-debtor releases.

The best research indicates that the asbestos crisis will not abate until the middle of this century.<sup>23</sup> Through 2002, 730,000 persons had brought claims for asbestos injuries.<sup>24</sup> But "[t]ens of millions of Americans" were exposed to the substance.<sup>25</sup> Thus, while the pace of filings has decreased from the highs of the

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<sup>17</sup> Section 524(g) was enacted as part of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994).

<sup>18</sup> See *infra* Part V.

<sup>19</sup> See 11 U.S.C. § 524(g)(4).

<sup>20</sup> See *infra* Part VI.

<sup>21</sup> See *infra* Parts V.C., VI.B.

<sup>22</sup> 11 U.S.C. § 1129(a)(7) (requiring that dissenting creditors in a Chapter 11 reorganization receive at least as much they would receive if the debtor liquidated under Chapter 7).

<sup>23</sup> RAND, *supra* note 2, at 17-18 (citing studies that predict continued cancer deaths resulting from asbestos up through 2049); see also Samuel Issacharoff, "Shocked": *Mass Torts and Aggregate Asbestos Litigation After Amchem and Ortiz*, 80 TEX. L. REV. 1925, 1925 (2002) (after setting forth some sobering statistics, the author concludes that "it is readily apparent that the end of asbestos litigation is decades away").

<sup>24</sup> RAND, *supra* note 2, at xxxiv, 2, 70-71; see also Lester Brickman, *An Analysis of the Financial Impact of S. 852: The Fairness in Asbestos Injury Resolution Act of 2005*, 27 CARDOZO L. REV. 991, 992 (2005) ("Since each plaintiff sues approximately sixty to seventy different defendants and bankruptcy trusts, the total number of claims probably exceeds 50,000,000.").

<sup>25</sup> RAND, *supra* note 2, at 2. Expert testimony at one hearing indicated that 25 million Americans came into contact with asbestos-containing products and that 12 million of those people were still alive in 1998. See *In re Nat'l Gypsum Co.*, 257 B.R. 184, 196 n.3 (Bankr. N.D. Tex. 2000).

late 1990s and early 2000s,<sup>26</sup> some experts estimate that more than half of the total claims have yet to be asserted.<sup>27</sup>

The more recent waves of litigation have driven an increasing number of defendants into bankruptcy.<sup>28</sup> This trend is expected to persist.<sup>29</sup> Section 524(g) will thus continue to play a crucial role in addressing asbestos liabilities.<sup>30</sup> And non-debtor releases, issued under both that statute and § 105(a), are certain to be a regular feature of asbestos bankruptcies.<sup>31</sup> Accordingly, the need for careful exploration of the powers granted by § 524(g) is pressing. Most of the scholarship on the statute, however, has focused on other parts of the law.<sup>32</sup> This

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<sup>26</sup> See RAND, *supra* note 2, at xxxiv, 72-73 (noting that the rate of filings increased significantly in the late 1990s and early 2000s); Patrick M. Hanlon & Anne Smetak, *Asbestos Changes*, 62 N.Y.U. ANN. SURV. AM. L. 525, 593-95 (2007) (documenting a decrease in claims filed in 2004 and 2005).

<sup>27</sup> RAND, *supra* note 2, at 105-06; see also *id.* at xxvi (noting that, as of the end of 2002, while “[e]stimates . . . vary, . . . at most, only about three-quarters of . . . claimants have come forward”); Brickman, *supra* note 24, at 992 (“[T]he latest estimates are that 1,000,000 new claimants will emerge over the next forty-five years.”). According to one well-respected estimate, over 120,000 cancer deaths resulting from asbestos had not yet occurred as of 2005. See RAND, *supra* note 2, at 15.

<sup>28</sup> See RAND, *supra* note 2, at 109-10 (of the estimated seventy-three asbestos bankruptcies through the summer of 2004, thirty-seven were commenced in 2000 or later).

<sup>29</sup> See James L. Stengel, *The Asbestos End-Game*, 62 N.Y.U. ANN. SURV. AM. L. 223, 266 (2006) (predicting “substantial additions” to the list of asbestos bankruptcies if Congress fails to pass comprehensive reform legislation); Hanlon & Smetak, *supra* note 26, at 603 (predicting that changes in asbestos litigation will motivate “more and more companies . . . to seek the resolution . . . that bankruptcy provides”). For a recent asbestos bankruptcy filing, see Prepackaged Plan of Reorganization of T H Agriculture & Nutrition, L.L.C. Under Chapter 11 of the Bankruptcy Code, *In re T H Agric. & Nutrition, L.L.C.*, No. 08-14692 (Bankr. S.D.N.Y. filed Nov. 24, 2008).

<sup>30</sup> Katherine Porter, *Recent Issues in Asbestos Bankruptcies*, NORTON ANN. SURV. BANKR. L., Oct. 2004 Part I § H, at 224 (“The scope and security of the protection [offered by the statute] have rendered § 524(g) the favored method for resolving asbestos liability.”).

<sup>31</sup> Cf. Susan Power Johnston & Katherine Porter, *Extension of Section 524(g) of the Bankruptcy Code to Nondebtor Parents, Affiliates, and Transaction Parties*, 59 BUS. LAW. 503, 512 (2004) (“The most remarkable, and desirable, power of § 524(g) is the statute’s authorization of a broad channeling injunction that offers protection to a broad group of parties in interest, in addition to protecting the debtor.”); see also *In re Combustion Eng’g, Inc.*, 391 F.3d 190, 204 (3d Cir. 2004) (observing that ABB Limited, the ultimate parent of the debtor, moved the debtor into bankruptcy to “cleanse” both the debtor and two non-bankrupt affiliates of asbestos liabilities).

<sup>32</sup> See, e.g., S. Todd Brown, *Section 524(g) Without Compromise: Voting Rights and the Asbestos Bankruptcy Paradox*, 2008 COLUM. BUS. L. REV. 841 (2008) (offering various criticisms of the operation of 524(g) with a particular focus on the deprivation of future claimants’ rights); William P. Shelley et al., *The Need for Transparency Between the Tort System and Section 524(g) Asbestos Trusts*, 17 NORTON J. BANKR. L. & PRAC. 2 Art. 3 257 (2008) (arguing that a lack of transparency in the operating procedures of asbestos litigation trusts has enabled some plaintiffs to obtain double recovery on their claims, unfairly burdening defendants); Mark D. Plevin et al., *The Future Claims Representative in Prepackaged Bankruptcies: Conflicts of Interest, Strange Alliances, and Unfamiliar Duties for Burdened Bankruptcy Courts*, 62 N.Y.U. ANN. SURV. AM. L. 271, 272 (2006) [hereinafter Plevin et al., *Future Claims Representative*] (arguing that, by allowing debtors and present claimants to appoint future claims representatives, courts have denied future claimants

article begins the necessary exploration of § 524(g)'s non-debtor release provisions.<sup>33</sup> It also addresses asbestos third-party releases granted under § 105(a).

Part II briefly reviews the asbestos-related tort litigation. Part III provides an overview of the Manville bankruptcy, perhaps the most significant event in the history of the asbestos litigation crisis. Part IV contains a detailed survey of the law governing third-party releases in non-asbestos cases. Part V outlines § 524(g) and the case law implementing the act.

Part VI contains the main argument of this Article. In it, I identify and explain the critical protections overlooked by courts and litigants alike, protections that should be addressed before a non-debtor release is granted in an asbestos case. The most crucial protection is that tort claimants have a legal right to demand payment in full under the reorganization plan on any extinguished claims against third parties. Finally, the Conclusion offers some closing remarks.

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proper and independent representation in bankruptcy cases); Brickman, *supra* note 24, at 1000-01 n.34 (arguing that instead of structuring § 524(g) litigation trusts to “effectively distinguish” valid and invalid tort claims, trusts are structured “to favor the interests of the lawyers controlling the trusts’ creation by, for example, paying their claims earlier and at higher levels than claims that arise later in the process without regard to merit or causation”); Katherine M. Anand, Note, *Demanding Due Process: The Constitutionality of the § 524 Channeling Injunction and Trust Mechanisms that Effectively Discharge Asbestos Claims in Chapter 11 Reorganization*, 80 NOTRE DAME L. REV. 1187, 1199-1211, 1222 (2005) (concluding that § 524(g) is unconstitutional because it deprives future claimants of procedural due process by permitting a court to discharge future claims without giving the claimants an adequate opportunity to participate in the case).

Much of the criticism applicable to courts’ implementation of § 524(g), flows from the non-judicial and expedited procedures used in pre-packaged bankruptcies. A “pre-packaged” reorganization is one in which “plan negotiations, distribution of disclosure statements, and voting all take place before the bankruptcy case is filed.” Mark D. Plevin et al., *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. TEX. L. REV. 883, 888 (2003) [hereinafter Plevin et al., *Pre-Packaged Asbestos Bankruptcies*]. In such cases, the debtor usually files its disclosure statement and plan of reorganization along with its Chapter 11 petition. *Id.* Asbestos debtors often use the “pre-pack structure.” *See id.* at 889-907 (summarizing three asbestos pre-packs). Plevin and his co-authors argue that because plan negotiations in such cases generally take place in secret, the future claims representative is unable to effectively act on behalf of the future claimants, and conflicts of interest infect the process. *See id.* at 907-08. As a result, various provisions of § 524(g) and other parts of the Code are violated. *See, e.g., id.* at 907-08 (explaining that because the negotiations take place in secret, plaintiffs’ lawyers who know about the negotiation are able to obtain favorable treatment for their clients vis-à-vis other asbestos claimants); *id.* at 913-16 (explaining that, in pre-packs, similarly situated tort claimants “generally do not receive similar treatment”); *see also* Ronald Barliant et al., *From Free-Fall to Free-For-All: The Rise of Pre-Packaged Asbestos Bankruptcies*, 12 AM. BANKR. INST. L. REV. 441 (2004) (presenting numerous criticisms of “pre-packaged” asbestos bankruptcies, including conflicts of interest, improper conversion of present claims into future claims, improper classification of claims, and discriminatory treatment of claims); *id.* at 446 (contending that “the rapid pace at which [asbestos] bankruptcies are conducted” has led to the sacrifice of “the procedural and substantive requirements of the Bankruptcy Code”); RAND, *supra* note 2, at 119 (noting that pre-packs can reduce the length of asbestos bankruptcies “to as little as three to six months”).

<sup>33</sup> It should be noted that two essays have discussed the non-debtor release provisions of § 524(g). *See* Porter, *supra* note 30, at 219-40; *see* Johnston & Porter, *supra* note 31, at 503-26.

## II. THE ASBESTOS TORT LITIGATION

Asbestos is a strong, durable, fireproof, heat-resistant material.<sup>34</sup> It is also “abundant and inexpensive to mine and process.”<sup>35</sup> As a result, asbestos was used in numerous commercial and residential settings up through the 1970s.<sup>36</sup> Products that contained asbestos included building insulation,<sup>37</sup> construction materials, and automotive parts such as brake linings.<sup>38</sup>

Unfortunately, asbestos is extremely dangerous. It gives off fibers that can permanently lodge in a person’s lungs if inhaled.<sup>39</sup> These particles can cause a variety of lung ailments, such as lung cancer (including malignant mesothelioma), asbestosis, and pleural plaque (which is a “harmful buildup that lines the lungs”).<sup>40</sup> While these illnesses vary in seriousness, all can be deadly.<sup>41</sup> Asbestos is also linked to numerous diseases unrelated to the lungs.<sup>42</sup>

Asbestos has a very long latency period. A person usually does not become ill until twenty to forty years after his or her first exposure.<sup>43</sup> Moreover, while persons who directly handled asbestos are the ones most often impacted, many have been infected, and sometimes even killed, by inhaling fibers carried on the clothing of family members.<sup>44</sup>

While the hazardous nature of asbestos has been known for thousands of years,<sup>45</sup> it was not until the publication of Dr. Irving Selikoff’s breakthrough medical research in the 1960s that litigation started to take off.<sup>46</sup> The pace of filings accelerated further after the 1973 *Borel v. Fibreboard* decision,<sup>47</sup> in which the Fifth Circuit ruled that asbestos manufacturers were strictly liable to persons injured because of exposure to their product.<sup>48</sup> These cases brought to light evidence that manufacturers were aware of the dangers of asbestos as far back as the 1930s but did not disclose the risks.<sup>49</sup>

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<sup>34</sup> RAND, *supra* note 2, at 11; Frank J. Macchiarola, *The Manville Personal Injury Settlement Trust: Lessons for the Future*, 17 CARDOZO L. REV. 583, 588 (1996).

<sup>35</sup> RAND, *supra* note 2, at 11.

<sup>36</sup> *Id.*

<sup>37</sup> Macchiarola, *supra* note 34, at 588.

<sup>38</sup> Stengel, *supra* note 29, at 226.

<sup>39</sup> Macchiarola, *supra* note 34, at 588.

<sup>40</sup> *Id.* at 588-89.

<sup>41</sup> Findley v. Blinken (*In re* Joint E. & S. Dist. Asbestos Litig.), 129 B.R. 710, 740 (Bankr. E. & S.D.N.Y. 1991), *vacated*, 982 F.2d 721 (2d Cir. 1992).

<sup>42</sup> RAND, *supra* note 2, at xix. For a good overview of the health impacts of asbestos, see *id.* at 12-14.

<sup>43</sup> *Id.* at 15 (“Typically, [twenty] to [forty] years elapse between the first exposure to asbestos and disease manifestation.”).

<sup>44</sup> Macchiarola, *supra* note 34, at 589.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 592.

<sup>47</sup> RAND, *supra* note 2, at 1; Stengel, *supra* note 29, at 230 (explaining that asbestos litigation saw a “virtual explosion” after *Borel*).

<sup>48</sup> *Borel v. Fibreboard Paper Prods. Corp.*, 493 F.2d 1076 (5th Cir. 1973).

<sup>49</sup> RAND, *supra* note 2, at 22.

Asbestos litigation soon began to overwhelm the legal system.<sup>50</sup> First, the total number of cases introduced complex aggregation and joinder issues.<sup>51</sup> Second, asbestos litigation is “extremely complicated.”<sup>52</sup> For example, the long latency period and widespread use of asbestos raised difficult questions of causation and proof, as well as challenging procedural issues regarding statute of limitations and collateral estoppel.<sup>53</sup>

These challenges forced the courts to develop “unusual or imaginative solutions”<sup>54</sup> ranging from new docket practices and case management techniques,<sup>55</sup> to the increased usage of special masters and expert advisors to juries.<sup>56</sup> One commentator concludes that the judges presiding over asbestos cases frequently transformed their role from “passive administrator of justice” to “active participant in the litigation.”<sup>57</sup> In addition to the courts, state legislatures adopted new laws to address aspects of the litigation.<sup>58</sup>

While these legal developments brought about some positive results, the asbestos crisis is far from over.<sup>59</sup> And it has changed in shape over time. During the first phase of the litigation, most claims flowed from industries where working conditions exposed employees to high concentrations of asbestos fibers—including asbestos mining and manufacturing, construction, the railroads, and shipping.<sup>60</sup> Ultimately, the crush of lawsuits compelled numerous defendants operating in these fields to declare bankruptcy.<sup>61</sup> The plaintiffs then shifted their focus to more peripheral companies<sup>62</sup> operating in other fields of

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<sup>50</sup> *Id.* at 28 (noting that courts “struggled to manage asbestos caseloads”).

<sup>51</sup> *See* RAND, *supra* note 2, at 28, 43-44; Macchiarola, *supra* note 34, at 594 n.60.

<sup>52</sup> Macchiarola, *supra* note 34, at 594.

<sup>53</sup> *Id.* at 594-95 & n.60. It should also be noted that asbestos litigation is incredibly expensive. *See generally*, RAND, *supra* note 2, at 92-106 (noting, *inter alia*, that the total costs of the asbestos litigation was roughly seventy billion dollars through 2002, and that forty billion dollars went to litigation costs; the amount actually paid to claimants was only thirty billion dollars). Some experts predict that the total economic cost of asbestos personal injury claims will be \$265 billion. *See* RAND, *supra* note 2, at 105.

<sup>54</sup> Macchiarola, *supra* note 34, at 590; *accord* RAND, *supra* note 2, at xx (“Trial judges developed innovative procedures in the 1980s to manage large asbestos caseloads.”).

<sup>55</sup> *See, e.g.*, RAND, *supra* note 2, at 28-30 (summarizing “case aggregation” techniques implemented by courts, such as global case management orders, multi-party settlement negotiations, pre-trial and trial consolidations, and transferring all cases in a given jurisdiction to a single court, among other techniques).

<sup>56</sup> Macchiarola, *supra* note 34, at 590 n.33, 595.

<sup>57</sup> *Id.* at 590-91.

<sup>58</sup> *See, e.g.*, RAND, *supra* note 2, at 25 (discussing changes to statutes of limitations to assist plaintiffs who do not discover their injuries until years after exposure).

<sup>59</sup> *See supra* notes 23-27 and accompanying text.

<sup>60</sup> RAND, *supra* note 2, at 76.

<sup>61</sup> *See* RAND, *supra* note 2, at 48 (“As filings surged, many of the asbestos product manufacturers that plaintiff attorneys had traditionally targeted as lead defendants filed for bankruptcy.”); *see also id.* at 111 (listing the companies in the initial wave of asbestos bankruptcies, which includes key players such as Johns-Manville, UNR, and Celotex).

<sup>62</sup> *Id.* at xxiii.

commerce.<sup>63</sup> Many of these firms had only a tangential connection to asbestos.<sup>64</sup> Through 2002, at least 8400 distinct parties had been named as defendants in asbestos lawsuits,<sup>65</sup> and the alleged tortfeasors come from a broad spectrum of U.S. industries, though the litigation has been heaviest in a select few.<sup>66</sup>

Another change was the dramatic increase in the number of lawsuits filed by parties who are “unimpaired”—i.e., their medical condition does not inhibit their capacity to perform everyday activities, though they have suffered legally cognizable injuries.<sup>67</sup> Plaintiffs with claims of this type appear to be an increasing portion of new actions.<sup>68</sup>

These changes have driven courts to develop further procedural innovations such as deferred and expedited dockets.<sup>69</sup> And state legislatures have once again passed laws in an attempt to address the situation, including new venue rules to restrict forum shopping and mass consolidations<sup>70</sup> and “medical criteria legislation” that “require plaintiffs to provide evidence at the outset of the case that they have a physical impairment due to asbestos . . . exposure.”<sup>71</sup>

Throughout the history of the asbestos crisis, courts and legislators have made several attempts to implement a global resolution. The courts focused on the usage of settlement class actions. But these efforts were stymied by the

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<sup>63</sup> *Id.* at 76-77.

<sup>64</sup> See, e.g., Kenneth S. Rivlin & Jamaica D. Potts, *Not So Fast: The Sealed Air Asbestos Settlement and Methods of Risk Management in the Acquisition of Companies with Asbestos Liabilities*, 11 N.Y.U. ENVTL. L.J. 626, 626-28 (2003) (summarizing how Sealed Air Corporation, a company that never manufactured or used asbestos-containing materials in its products, got drawn into the asbestos litigation).

<sup>65</sup> RAND, *supra* note 2, at 79.

<sup>66</sup> *Id.* at 81-84.

<sup>67</sup> *Id.* at xxv, 7-8.

<sup>68</sup> *Id.* at xxv, 75-76; Barliant, *supra* note 32, at 443 (“Recent studies indicate that up to ninety percent of current asbestos claims are filed by unimpaired claimants.”).

<sup>69</sup> RAND, *supra* note 2, at xxi (discussing “deferred dockets,” a system under which plaintiffs who are not “functionally impaired but who do have a legally cognizable injury,” can file an action to avoid the statute of limitations bar, but the action is not actually litigated until the plaintiff develops more serious symptoms); *id.* (discussing “expedited dockets,” which are dockets that permit plaintiffs with more serious injuries to litigate their claims first).

<sup>70</sup> Hanlon & Smetak, *supra* note 26, at 569-83.

<sup>71</sup> *Id.* at 566-67.

Supreme Court decisions in the *Amchem* and *Ortiz* cases.<sup>72</sup> And Congress has been unable to enact a comprehensive statutory solution.<sup>73</sup>

Given these failures, bankruptcy remains a critical forum for the resolution of asbestos liability.<sup>74</sup> And corporate debtors will continue using the bankruptcy system to shield related non-debtors from asbestos lawsuits. The first case in which an appellate court approved of such protection was the bankruptcy of Johns-Manville. Part III reviews that case in detail.

### III. THE JOHNS-MANVILLE BANKRUPTCY

#### A. Pre-confirmation Proceedings

The Johns-Manville Corporation was the world's largest producer of asbestos and one of the leading manufacturers of asbestos products.<sup>75</sup> As a result of the scientific studies of asbestos published in the 1960s, an increasing number of product liability lawsuits were filed against the company throughout that decade and the 1970s.<sup>76</sup> By the early 1980s, Manville was a defendant in

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<sup>72</sup> See *Amchem Prods. v. Windsor*, 521 U.S. 591 (1997); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999); RAND, *supra* note 2, at xx-xxi (summarizing the failed attempts to address asbestos litigation via settlement class actions (“When the settlement was rejected by the U.S. Supreme Court in *Amchem Products v. Windsor*, and when the Court subsequently rejected a similar class settlement of asbestos claims against another major defendant in *Ortiz v. Fibreboard Corp.*, efforts to achieve a global resolution of asbestos litigation through class action litigation collapsed.” (internal citations omitted))); see also *id.* at xx (“To date, notwithstanding extensive efforts over time, neither the parties nor the courts have arrived at a comprehensive settlement of asbestos claims.”).

<sup>73</sup> See Stengel, *supra* note 29, at 241 & nn.83-86 (identifying various congressional proposals and observing that “so far these efforts have not resulted in a solution”); Neil, *supra* note 4, at 28 (noting that many practitioners involved in asbestos litigation doubt that national legislation resolving the crisis will ever be passed).

<sup>74</sup> See Plevin et al., *Future Claims Representative*, *supra* note 32, at 272 (“Section 524(g) arguably provides the *only* current mechanism by which a company free itself from” from the drag of asbestos liability, “providing even healthy companies with unusual incentives to enter bankruptcy to take advantage of this benefit.”); Fred S. Hodara & Robert J. Stark, *Protecting Distributions for Commercial Creditors in Asbestos-Related Chapter 11 Cases*, 10 J. BANKR. L. & PRAC. 383, 388 (2001) (“Following *Windsor* and *Ortiz*, Chapter 11 appears to be the only viable legal procedure for global resolution of a company’s mass asbestos-related exposure.”); cf. RAND, *supra* note 2, at xx (observing that one of “the most significant developments” in the first half of this decade was “the increased use of bankruptcy reorganization to develop administrative processes for resolving current and future claims.”).

<sup>75</sup> *Kane v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 843 F.2d 636, 639 (2d Cir. 1988). For a brief but excellent history of Manville and its litigation troubles, see generally Macchiarola, *supra* note 34, at 591-96.

<sup>76</sup> *In re Johns-Manville Corp.*, 843 F.2d at 639.

approximately 12,500 lawsuits brought by over 16,000 plaintiffs.<sup>77</sup> And parties were filing new claims at a rate of 425 per month.<sup>78</sup>

Nonetheless, Manville had sufficient financial resources to meet its existing obligations to *current* tort claimants and commercial creditors.<sup>79</sup> The company's primary concern was *future* liabilities.<sup>80</sup> Manville's internal epidemiological studies indicated that persons exposed to the company's asbestos would ultimately file approximately 50,000 to 100,000 additional claims.<sup>81</sup> All together, Manville estimated it faced approximately two-billion dollars in potential liability.<sup>82</sup> In short, the company was a "financially besieged enterprise in desperate need of reorganization of its crushing real debt, both present and future."<sup>83</sup> Manville thus filed for bankruptcy protection under Chapter 11 on August 26, 1982.<sup>84</sup>

The Manville bankruptcy was one of the most complicated in history,<sup>85</sup> due largely to the scope and nature of the debtor's tort liability. The company hoped to resolve *all* of its asbestos obligations through Chapter 11.<sup>86</sup> This meant that the bankruptcy process had to address "future asbestos health claimants."<sup>87</sup> These claimants were persons "who had been exposed to Manville's asbestos prior to the August 1982 petition date but had not yet shown any signs of disease."<sup>88</sup> Because they were not ill during the pendency of the case, none of these parties filed claims in the bankruptcy.<sup>89</sup> Their identities were thus

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<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *See id.* ("From the outset of the reorganization, all concerned recognized that the impetus for Manville's action was not a present inability to meet debts.")

<sup>80</sup> *See id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *In re Johns-Manville Corp.*, 68 B.R. 618, 632 (Bankr. S.D.N.Y. 1986) (internal quotation marks omitted), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636 (2d Cir. 1988).

<sup>84</sup> *Kane v. Johns-Manville (In re Johns-Manville Corp.)*, 843 F.2d 636, 639 (2d Cir. 1988).

*Kane v. Johns-Manville (In re Johns-Manville Corp.)*, 843 F.2d 636, 639 (2d Cir. 1988).

<sup>85</sup> *In re Johns-Manville Corp.*, 68 B.R. at 624. As the Bankruptcy Court elaborated:

Indeed, this case is also one of the most hard fought in reorganization annals. It has been estimated that there have been some 900 applications or motions, over 1000 orders, approximately 55 adversary proceedings, over 40 appeals (not including writs addressed to the U.S. Supreme Court), 300 odd hearings and thousands of pages of court transcripts.

*Id.*

<sup>86</sup> *In re Johns-Manville Corp.*, 36 B.R. 743, 745 (Bankr. S.D.N.Y. 1984) ("From the inception of this case, it has been obvious to all concerned that the very purpose of the initiation of these proceedings is to deal in some fashion with claimants exposed to the ravages of asbestos dust who have not as of the filing date manifested symptoms of asbestos disease."), *aff'd*, 52 B.R. 940 (S.D.N.Y. 1985).

<sup>87</sup> *In re Johns-Manville Corp.*, 843 F.2d at 639.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

unknown.<sup>90</sup> Moreover, the Asbestos Health Committee appointed to represent creditors suffering personal injury was only willing to represent *present* claimants—persons who had already developed an asbestos-related disease.<sup>91</sup> Finally, the case law was deeply divided over whether future claimants even possessed “claims” cognizable in bankruptcy proceedings.<sup>92</sup> Historically, bankruptcy was not available to discharge “future obligations to unidentified persons who cannot, even theoretically, appear in the case to protect their own interest.”<sup>93</sup>

Judge Lifland (the presiding bankruptcy judge) resolved the *procedural* problem of future claimant participation in the formulation of the debtor’s plan of reorganization by appointing a legal representative for those parties.<sup>94</sup> The court reasoned that even if the future claimants did not have bankruptcy “claims,” they were at least “parties in interest” under § 1109(b) and thus were entitled to be heard in the case.<sup>95</sup> The *substantive* issue—how to address the future claimants’ right to tort damages—was left for the plan of reorganization.

## B. THE PLAN OF REORGANIZATION

### 1. The Litigation Trusts

Manville’s plan of reorganization needed to provide relief for current asbestos victims “without exhausting the resources necessary to care for tomorrow’s.”<sup>96</sup> At the same time, it had to address the rights of the debtor’s general creditors and shareholders.<sup>97</sup> The ultimate plan was the “product of more than four years of effort to grapple with a social, economic and legal crisis of national importance within the statutory framework of [C]hapter 11.”<sup>98</sup> And it

<sup>90</sup> *Id.*

<sup>91</sup> See *Manville Corp. v. The Equity Sec. Holders’ Comm. (In re Johns-Manville Corp.)*, 60 B.R. 842, 845 (S.D.N.Y. 1986), *rev’d*, 801 F.2d 60 (2d Cir. 1986).

<sup>92</sup> See *In re Johns-Manville Corp.*, 68 B.R. 618, 628-29 (Bankr. S.D.N.Y. 1986) (reviewing case law), *aff’d*, 78 B.R. 407 (S.D.N.Y. 1987), *aff’d*, 843 F.2d 636 (2d Cir. 1988). The Code defines “claim” to mean, *inter alia*, a “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” 11 U.S.C. § 101(5)(A) (2006). The courts remains split on whether this definition encompasses future claims. Plevin et al., *Future Claims Representative*, *supra* note 32, at 276 n.11 (summarizing the split).

<sup>93</sup> Plevin et al., *Future Claims Representative*, *supra* note 32, at 277.

<sup>94</sup> *In re Johns-Manville Corp.*, 36 B.R. 743 (Bankr. S.D.N.Y. 1984), *aff’d*, 52 B.R. 940 (S.D.N.Y. 1985).

<sup>95</sup> *Id.* at 748-49, *aff’d*, 52 B.R. at 943. Section 1109(b) provides that a “party in interest . . . may raise and may appear and be heard on any issue in a case under this chapter.” 11 U.S.C. § 1109(b).

<sup>96</sup> See *In re Johns-Manville Corp.*, 78 B.R. 407, 408 (S.D.N.Y. 1987), *aff’d*, 843 F.2d 636 (2d Cir. 1988).

<sup>97</sup> *Id.*

<sup>98</sup> *In re Johns-Manville Corp.*, 68 B.R. 618, 621 (Bankr. S.D.N.Y. 1986), *aff’d*, 78 B.R. 407 (S.D.N.Y. 1987), *aff’d*, 843 F.2d 636 (2d Cir. 1988).

was marked by the usage of extraordinary remedies necessary to address the mass tort at the heart of the proceeding.<sup>99</sup>

The centerpiece of Manville's reorganization plan was the creation of two trusts—the "Asbestos Health Trust"<sup>100</sup> and the "Property Damage Trust"<sup>101</sup>—with the responsibility for liquidating and satisfying all asbestos-related claims against the debtor, including future claims.<sup>102</sup> The reorganization plan placed those with asbestos property damage claims in Class Three.<sup>103</sup> *Present* asbestos health claims were put in Class Four.<sup>104</sup> *Future* asbestos health claimants were not included in any traditional plan class; instead, they were separately grouped under the heading "other asbestos obligations."<sup>105</sup> The AH Trust was established for parties suffering from asbestos-related diseases<sup>106</sup>—i.e., parties holding either Class Four claims or other asbestos obligations. Under the terms of this Trust, a claimant suffering personal injury caused by Manville's asbestos first had to engage in settlement negotiations with representatives of the Trust.<sup>107</sup> If the parties failed to resolve the dispute, the claimant could elect mediation, binding arbitration, or tort litigation in civil court.<sup>108</sup> The claimant was permitted to collect in full any compensatory damages awarded via these proceedings.<sup>109</sup> The PD Trust was similarly structured, but with the purpose of resolving asbestos-related property claims<sup>110</sup>—i.e., Class Three claims.

Manville initially funded the AH Trust with \$815 million in previously-held cash, receivables, and insurance proceeds from settlements with its liability insurance carriers.<sup>111</sup> The plan also obligated Manville to pay the AH Trust \$75 million per year for twenty-four years post-reorganization, commencing three years after the Trust's creation.<sup>112</sup> Together, these funding arrangements would ultimately provide the AH Trust with over \$2.5 billion.<sup>113</sup>

<sup>99</sup> The bankruptcy court described the plan as "of necessity, both creative and pragmatic." *Id.*

<sup>100</sup> The "AH Trust."

<sup>101</sup> The "PD Trust."

<sup>102</sup> See *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 640 (2d Cir. 1988) (describing the AH Trust as the "cornerstone" of the plan); *In re Johns-Manville Corp.*, 68 B.R. at 621-22 (outlining the key features of the two Trusts). The Trusts were "[o]ne of the most innovative and unique features of the Manville Plan of Reorganization." *Id.* at 621.

<sup>103</sup> *In re Johns-Manville Corp.*, 843 F.2d at 640 n.1. Parties in this class included "schools, colleges, hospitals, government bodies, and other persons and entities." State Gov't Creditors Comm. v. McKay (*In re Johns-Manville Corp.*), 920 F.2d 121, 123 (2d Cir. 1990).

<sup>104</sup> *In re Johns-Manville Corp.*, 843 F.2d at 640 n.1.

<sup>105</sup> *Id.*

<sup>106</sup> *In re Johns-Manville Corp.*, 68 B.R. at 621.

<sup>107</sup> *In re Johns-Manville Corp.*, 843 F.2d at 640.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *In re Johns-Manville Corp.*, 68 B.R. at 622.

<sup>111</sup> *Id.* at 621.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

The reorganization plan also mandated that the AH Trust “own or have access to up to eighty-percent of Manville’s common stock.”<sup>114</sup> And the Trust possessed the right to receive up to twenty percent of the reorganized debtor’s profits, beginning four years after the Trust’s inception, and continuing indefinitely, until all asbestos health claims were satisfied.<sup>115</sup>

The PD Trust received \$125 million and a portion of the insurance settlement proceeds.<sup>116</sup> In addition, the PD Trust was entitled to receive any remaining assets of the AH Trust after all of the personal injury claims were paid.<sup>117</sup>

## 2. The Channeling Injunction

Under the plan, Manville’s post-bankruptcy operations were a critical source of funding for the AH and PD Trusts. The success of the Trusts was dependent upon maximizing and preserving the reorganized debtor’s value as a going concern.<sup>118</sup> Accordingly, Manville needed protection from the prospect of continued tort litigation after the company emerged from Chapter 11 so that it would be free to earn the profits necessary to fund the Trusts.<sup>119</sup>

The discharge<sup>120</sup> was not, by itself, sufficient to achieve that end because it was unclear whether future asbestos claimants held “claims” that were dischargeable in the bankruptcy.<sup>121</sup> Accordingly, the plan provided that the Bankruptcy Court would issue an injunction to “supplement” the effect of the

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<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 622.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* (“The imperative rather, is to ensure . . . the continuing viability of the reorganized corporation, which will fund the Trust, whatever the number and amount of claims happen to be.”); *Kane v. Johns-Manville (In re Johns-Manville Corp.)*, 843 F.2d 636, 640 (2d Cir. 1988) (“The purpose of the Trust is to provide a means of satisfying Manville’s ongoing personal injury liability while allowing Manville to maximize its value by continuing as an ongoing concern.”).

<sup>119</sup> *See In re Johns-Manville Corp.*, 843 F.2d at 640.

<sup>120</sup> Under § 1141(d), the confirmation of a plan of reorganization discharges a corporate debtor from all of its pre-confirmation debts (with limited exceptions). 11 U.S.C. § 1141(d)(1), (3) & (6) (2006). Section 524 sets forth the precise impact of a discharge. *See, e.g.*, 11 U.S.C. § 524(a)(2) (the discharge serves as injunction barring all attempts to collect on any debt “as a personal liability of the debtor”); *id.* at § 524(e) (the discharge “does not affect the liability of any other entity on, or the property of any other entity for, such debt”).

<sup>121</sup> As noted previously, the case law was divided on whether future claimants hold bankruptcy “claims.” *See supra* notes 92-93 and accompanying text. Confirmation of a reorganization plan only “discharges the debtor from any debt.” 11 U.S.C. § 1141(d)(1)(A) (2006). And a debt is defined as “liability on a claim.” *Id.* § 101(12). Therefore, if the future claimants did not hold “claims,” Manville’s potential liability to them would not be discharged. *See also id.* § 1141(d)(1)(A) (“[C]onfirmation of a plan . . . discharges the debtor from any debt that arose before the date of such confirmation” (emphasis added)).

discharge.<sup>122</sup> That injunction bars any person from asserting “Claims, Interests or Other Asbestos Obligations . . . against the Debtor or its subsidiaries or any settling insurance company.”<sup>123</sup> Parties with future claims are covered via the term “Other Asbestos Obligations.”<sup>124</sup> Present *and* future asbestos claimants are thus limited to recovery from the Trusts.<sup>125</sup> As Judge Lifland explained, “the injunction, effectively channels all asbestos related claims and obligations away from the reorganized entity and targets [them] towards the AH and PD Trusts for resolution.”<sup>126</sup> The channeling injunction was designed to ensure that the future claimants would be treated the same as present claimants under the plan even though they were not allowed full creditor status.<sup>127</sup> Both sets of parties were entitled to a complete recovery from the Trusts,<sup>128</sup> but were restricted from suing Manville and the settling insurance carriers.

### 3. Plan Approval and Confirmation

The promise of recovery in full to asbestos claimants was not a guarantee. As part of its ruling on “feasibility,”<sup>129</sup> the bankruptcy court found that Manville established “by convincing evidence” that it would be able to meet its obligations under the plan.<sup>130</sup> But, full recovery for asbestos claimants was ultimately

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<sup>122</sup> *In re Johns-Manville Corp.*, 68 B.R. 618, 624 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636 (2d Cir. 1988).

<sup>123</sup> *Id.* (quoting the plan) (internal quotation marks omitted).

<sup>124</sup> *See In re Johns-Manville Corp.*, 843 F.2d at 640.

<sup>125</sup> *See id.* (“The Injunction provides that asbestos health claimants may proceed only against the Trust to satisfy their claims and may not sue Manville, its other operating entities, and certain other specified parties, including Manville’s insurers.”).

<sup>126</sup> *In re Johns-Manville Corp.*, 68 B.R. at 624.

<sup>127</sup> *In re Johns-Manville Corp.*, 843 F.2d at 640. As with the bankruptcy court’s conclusion that § 1109(b) permitted appointment of a future claims representative, see *supra* notes 94-95 and accompanying text, channeling the future claims to the Trusts via the supplemental injunction obviated the need to resolve whether the future claimants in fact held dischargeable bankruptcy claims. *See In re Johns-Manville Corp.*, 68 B.R. at 628 (explaining that other asbestos obligations would not be discharged, simply “subject to the [i]njunction”).

<sup>128</sup> Macchiarola, *supra* note 34, at 602 (“The Trust was bound by the Plan to . . . pay 100 percent of the victims’ claims.”).

<sup>129</sup> A bankruptcy court must find by a preponderance of the evidence that a plan of reorganization is “feasible,” *Danny Thomas Props. II Ltd. P’ship v. Beal Bank, S.S.B. (In re Danny Thomas Props. II Ltd. P’ship)*, 241 F.3d 959, 963 (8th Cir. 2001), that confirmation “is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor,” 11 U.S.C. § 1129(a)(11) (2006).

<sup>130</sup> *In re Johns-Manville Corp.*, 68 B.R. at 634-35. Judge Lifland continued:

Furthermore, the Debtor’s reasonable and credible projections of future earnings have established that the reorganized corporation is unlikely to face future proceedings under this title . . . . The evidence submitted by the Debtor as previously noted, provides a reasonable estimation, based upon known present claimants and reasonable

“subject to the Trust’s being sufficiently funded.”<sup>131</sup> Despite this contingency, the plan was “overwhelmingly accepted” by the asbestos health and property damage claimants.<sup>132</sup>

Certain objectors challenged the legality of the channeling injunction,<sup>133</sup> but they were overruled by Judge Lifland.<sup>134</sup> He found a statutory basis for the injunction in the general equitable powers granted by § 105(a),<sup>135</sup> and the channeling authority conferred by § 363.<sup>136</sup> The court explained that the injunction best protected the rights of the asbestos claimants by creating a body of funds from which all could recover.<sup>137</sup> Without the injunction, the parties would engage in “piece-meal dismemberment” of the debtor’s estate, which would harm the beneficiaries of the injunction.<sup>138</sup>

### C. The MacArthur Insurance Litigation

The channeling injunction enjoining the asbestos plaintiffs from suing Manville and its liability insurance companies was not reviewed on appeal. The Second Circuit held that the objectors lacked standing to challenge the injunction.<sup>139</sup> But the appellate court did assess a related ruling.

As explained in the previous section, both the AH and PD Trusts were funded, in part, by the proceeds of Manville’s settlement with its insurance carriers.<sup>140</sup> At the outset, Manville’s insurers took the position that the company’s insurance policies did not cover asbestos liability.<sup>141</sup> This forced the debtor to engage in “incredibly complex” litigation with the carriers over the scope of the policies.<sup>142</sup> Given the prospects for recovery and the likely delays, Manville attempted to settle the disputes with the hope of generating the proceeds

extrapolations from past experience and epidemiological data, of the number and amount of asbestos-related claims that the AH Trust will be required to satisfy.

*Id.* at 635. The second circuit affirmed, concluding that these findings were “not clearly erroneous.” *In re Johns-Manville Corp.*, 843 F.2d at 650; *see also In re Johns-Manville Corp.*, 68 B.R. at 633-34 (where the bankruptcy court noted, as part of its best interests of creditors analysis, that asbestos health and property damage claimants would receive payment in full on their tort claims).

<sup>131</sup> *In re Johns-Manville Corp.*, 843 F.2d at 642. Additionally, the promise of full recovery applied only to compensatory damages. Punitive damages were disallowed under the plan. *In re Johns-Manville Corp.*, 68 B.R. at 627-28.

<sup>132</sup> *In re Johns-Manville Corp.*, 68 B.R. at 621. Nearly ninety-six percent of the asbestos health claimants voting approved the Plan. *In re Johns-Manville Corp.*, 843 F.2d at 641.

<sup>133</sup> *In re Johns-Manville Corp.*, 68 B.R. at 624.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* at 625. For more on § 105(a), *see infra* note 191.

<sup>136</sup> *In re Johns-Manville Corp.*, 68 B.R. at 625. For additional detail regarding § 363(f), *see infra* notes 158-63, 334-45, and accompanying text.

<sup>137</sup> *In re Johns-Manville Corp.*, 68 B.R. at 626.

<sup>138</sup> *Id.*

<sup>139</sup> *Kane v. Johns-Manville (In re Johns-Manville Corp.)*, 843 F.2d 636, 644-45 (2d Cir. 1988).

<sup>140</sup> *See supra* note 111 and accompanying text.

<sup>141</sup> Barry L. Zaretsky, *Insurance Proceeds in Bankruptcy*, 55 BROOK. L. REV. 373, 405 (1989).

<sup>142</sup> *Id.* at 405-07.

necessary to fund the reorganization.<sup>143</sup> The parties eventually reached a compromise.<sup>144</sup>

The settlements with the insurers were a “cornerstone” of Manville’s plan of reorganization.<sup>145</sup> Under these agreements, the insurance companies paid the debtor \$770 million and, in exchange, were “relieved of all obligations related to the disputed policies.”<sup>146</sup> To effectuate the settlements, the bankruptcy court “enjoined all suits against the insurers” concerning the policies.<sup>147</sup> It also ordered that any claims subject to the injunction would attach only to the proceeds of the settlements.<sup>148</sup> The insurers demanded this protection because certain tort claimants and co-defendants in the asbestos litigation had brought direct actions against them.<sup>149</sup>

A distributor of Manville’s products, MacArthur, objected to the settlement and the supporting injunction.<sup>150</sup> MacArthur argued that it was a co-insured under the settled policies pursuant to a vendor endorsement that entitled Manville’s distributors to “insurance coverage for liability resulting from their sale of Manville’s products.”<sup>151</sup> Several plaintiffs had recently sued MacArthur for such sales activity.<sup>152</sup> Thus, the company contended, it was entitled to indemnification from the settling insurers under the policies and the channeling injunction was an illegal discharge that improperly extinguished its contractual rights.<sup>153</sup> The Bankruptcy Court overruled the objection<sup>154</sup> and the Second Circuit affirmed.

The appellate court explained that the injunction did “not offer the umbrella protection of a discharge in bankruptcy.”<sup>155</sup> Instead, it precluded “only those suits against the settling insurers that arise out of or relate to Manville’s insurance policies.”<sup>156</sup> Moreover, MacArthur’s claims were “not extinguished; they are simply channeled away from the insurers and redirected at the proceeds of the settlement.”<sup>157</sup>

As authority for the channeling injunction, the Second Circuit pointed to § 363(f).<sup>158</sup> That statute permits, in some circumstances, the sale of estate property

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<sup>143</sup> *Id.* at 407.

<sup>144</sup> *Id.*

<sup>145</sup> *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89, 90 (2d Cir. 1988).

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 91.

<sup>148</sup> *Id.*

<sup>149</sup> Zaretsky, *supra* note 141, at 407.

<sup>150</sup> *In re Johns-Manville Corp.*, 837 F.2d at 90.

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* at 91.

<sup>153</sup> *Id.*

<sup>154</sup> Zaretsky, *supra* note 141, at 407.

<sup>155</sup> *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89, 91 (2d Cir. 1988).

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

“free and clear” of a third party’s interest, such as a lien.<sup>159</sup> The third party’s rights are typically transferred—i.e., “channeled”—to the proceeds of the sale.<sup>160</sup> The court reasoned that because Manville’s policies belonged to the estate,<sup>161</sup> § 363(f) allowed the bankruptcy court to dispose of the insurance policies through the settlement and channel MacArthur’s claims to the settlement payments.<sup>162</sup> The injunction expressly barring MacArthur and others from suing the insurance companies was “necessary to effectuate the Court’s channeling authority . . . . The authority to issue the injunction is thus a corollary to the power to dispose of assets free and clear and to channel claims to the proceeds.”<sup>163</sup>

The Second Circuit found additional authority for the injunction in § 105(a).<sup>164</sup> It observed that this statute “has been construed liberally to enjoin suits that might impede the reorganization process.”<sup>165</sup> And the bankruptcy court found that direct actions against Manville’s insurers “would adversely affect property of the estate and would interfere with reorganization.”<sup>166</sup>

The Second Circuit admitted that the insurance settlement and the accompanying injunction were “not precisely the same as the traditional sale of real property free and clear of liens followed by a channeling of the liens to the proceeds of the sale.”<sup>167</sup> The insurance policies were not actually sold and MacArthur’s claim was distinct from a lien on property.<sup>168</sup> But “the underlying principle of preserving the debtor’s estate for the creditors and funneling claims to one proceeding in the bankruptcy court remains the same.”<sup>169</sup> Because the

<sup>159</sup> 11 U.S.C. § 363(f) (2006). See generally 3 COLLIER ON BANKRUPTCY ¶ 363.06 (15th ed. rev. 2005).

<sup>160</sup> The holder of the interest is entitled to adequate protection. 11 U.S.C. § 363(e). “The most common form of adequate protection is to have the lien or other interest attach to the proceeds of the sale.” 3 COLLIER ON BANKRUPTCY ¶ 363.06[9]. And “[i]t has long been recognized that when a debtor’s assets are disposed of free and clear of third-party interests, the third party is adequately protected if his interest is assertable against the proceeds of the disposition.” *In re Johns-Manville Corp.*, 837 F.2d at 94.

<sup>161</sup> *In re Johns-Manville Corp.*, 837 F.2d at 93 (citing, *inter alia*, 11 U.S.C. § 541(a)(1) (2006)). Section 541(a)(1) provides that a debtor’s estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case,” with only minor exceptions. 11 U.S.C. § 541(a)(1).

<sup>162</sup> *In re Johns-Manville Corp.*, 837 F.2d at 93.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* Section 105(a) provides, *inter alia*, that courts sitting in bankruptcy “may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a) (2006).

<sup>165</sup> *In re Johns-Manville Corp.*, 837 F.2d at 93.

<sup>166</sup> *Id.*

<sup>167</sup> *Id.* at 94. When a debtor actually sells an asset under § 363(f), the bankruptcy court may issue an injunction barring a creditor from attempting to enforce a preexisting lien on the property. *Fogel v. Zell*, 221 F.3d 955, 965 (7th Cir. 2000).

<sup>168</sup> *In re Johns-Manville Corp.*, 837 F.2d at 94.

<sup>169</sup> *Id.*

settlement was “essential . . . to a workable reorganization, it falls well within the bankruptcy court’s equitable powers.”<sup>170</sup>

#### IV. NON-DEBTOR RELEASES AFTER THE MANVILLE BANKRUPTCY

The Manville reorganization has had a dramatic impact on American tort and bankruptcy law.<sup>171</sup> As the first “mass tort bankruptcy,”<sup>172</sup> *Johns-Manville* signaled that Chapter 11 is an effective tool for addressing enterprise-threatening liability. And in the aftermath of the case, bankruptcy became a critical avenue for the resolution of mass torts.<sup>173</sup>

The case also significantly legitimized the extraordinary remedial devices used in the reorganization—including the appointment of a future claims representative, the establishment of a litigation trust to liquidate present and future tort claims, and the issuance of a channeling injunction which bars future claimants from suing the reorganized debtor and permits them to recover solely from the trust. For example, debtors facing mass tort claims now typically establish a litigation trust to manage these obligations.<sup>174</sup> And future claims representatives have become a common feature in such bankruptcies.<sup>175</sup> In short, *Johns-Manville* established a legal framework that numerous subsequent mass tort reorganizations have followed.<sup>176</sup>

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<sup>170</sup> *Id.*

<sup>171</sup> *Cf.* Macchiarola, *supra* note 34, at 597 (“Johns-Manville’s Chapter 11 bankruptcy proceeding was a threshold event in the disposition of mass tort cases.”).

<sup>172</sup> Frederick Tung, *The Future Claims Representative in Mass Tort Bankruptcy: A Preliminary Inquiry*, 3 *CHAP. L. REV.* 43, 72 (2000) (referring to *Johns-Manville* as “the first of the mass tort bankruptcy cases”).

<sup>173</sup> *See id.* at 44 & n.2 (explaining that bankruptcy and settlement class actions are the two legal avenues for addressing mass tort liability); Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 *U. ILL. L. REV.* 959, 965 (1997) (noting that “the bankruptcy court is quickly becoming the forum for resolution of many of the largest and most complex mass litigations.”). As noted in Part II, *supra* note 72 and accompanying text, the utility of settlement class actions was substantially undercut by the Supreme Court’s decisions in *Amchem Products v. Windsor*, 521 U.S. 591 (1997), and *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999).

<sup>174</sup> JEFF FERRIEL & EDWARD J. JANGER, *UNDERSTANDING BANKRUPTCY* 854 (2nd ed. 2007) (“Since its use in the Johns-Manville bankruptcy, cases involving mass tort claims have usually relied on a trust for the settlement of present and future claims.”); *see, e.g.*, *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 654-55 (6th Cir. 2002) (discussing some features of a “Settlement Facility” created to resolve the debtor’s mass tort liability arising from the production of silicone breast implants).

<sup>175</sup> *See* Tung, *supra* note 172, at 44 (explaining that the future claims representative is “at the center” of the bankruptcy approach to resolving mass torts).

<sup>176</sup> *See* RAND, *supra* note 2, at 110-11 (observing that the Manville case “created the model for resolving asbestos personal injury litigation under the protection of bankruptcy”); J. Maxwell Tucker, *The Clash of Successor Liability Principles, Reorganization Law, and the Just Demand that Relief be Afforded Unknown and Unknowable Claimants*, 12 *BANKR. DEV. J.* 1, 52 n.285

In addition to these developments, the Manville bankruptcy “pave[d] the way” for non-debtor releases.<sup>177</sup> Recall that the channeling injunction in that case did more than prohibit holders of future claims from suing the reorganized debtor. It barred present and future tort claimants from suing independent third parties—namely, Manville’s liability insurers.<sup>178</sup> Moreover, the bankruptcy court also enjoined MacArthur, an additional insured under Manville’s policies, from asserting its contract rights against the carriers.<sup>179</sup> Since Manville, bankruptcy orders extinguishing the liability of non-bankrupt third parties have become “increasingly common” in Chapter 11 reorganizations.<sup>180</sup> In the following two sub-parts, I review non-debtor releases generally and then address some special issues that arise when a non-debtor release extinguishes rights relating to insurance policies, as happened in *Johns-Manville*.

## A. Non-Debtor Releases In General

### 1. Non-Debtor Releases Defined

In this Article, the terms “non-debtor release” and “third-party release” refer to the extinguishing of a creditor’s claims against a non-debtor over the creditor’s objection. Such releases come in three basic forms: (1) a section in a Chapter 11 plan providing that certain claims against third parties are “released”;<sup>181</sup> (2) a permanent injunction in a Chapter 11 plan, or otherwise

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(1995) (asserting that the Johns-Manville Trust pioneered the approach of establishing a trust to pay future claimants); *see, e.g.*, *Unarco Bloomington Factory Workers v. UNR Indus., Inc.*, 124 B.R. 268, 271-72 (Bankr. N.D. Ill. 1990) (summarizing a Chapter 11 plan that substantially mirrored Manville’s in its treatment of asbestos tort claims); H.R. REP. No. 103-835, at 40 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3349 (explaining that UNR “has resolved its chapter 11 reorganization with a similar trust/injunction arrangement”).

<sup>177</sup> Brubaker, *supra* note 173, at 962 n.3; *accord* Silverstein, *supra* note 6, at 54.

<sup>178</sup> *See* Kane v. Johns-Manville Corp., (*In re* Johns-Manville Corp.), 843 F.2d 636, 640 (2d Cir. 1988).

<sup>179</sup> *See* MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 91 (2d Cir. 1988).

<sup>180</sup> Silverstein, *supra* note 6, at 18 (collecting authorities); *accord In re Transit Group, Inc.*, 286 B.R. 811, 815 (Bankr. M.D. Fla. 2002) (“In the last few years, debtors more frequently are seeking to expand the scope of the discharge to include the release of claims against non-debtor third parties and insiders.”); Brubaker, *supra* note 173, at 961 (observing that non-debtor releases are receiving “growing judicial acceptance” and that they “have regularly appeared in reorganization plans”); Howard C. Buschman III & Sean P. Madden, *The Power and Propriety of Bankruptcy Court Intervention in Actions Between Nondebtors*, 47 BUS. LAW. 913, 943 (1992) (noting “a trend among debtors to provide releases for nondebtors in reorganization plans”); Peter E. Meltzer, *Getting Out of Jail Free: Can the Bankruptcy Plan Process Be Used to Release Nondebtor Parties?*, 71 AM. BANKR. L.J. 1, 1 (1997) (observing that “the custom of attempting to include releases of nondebtor parties has become more and more prevalent”).

<sup>181</sup> *See, e.g.*, *Republic Supply Co. v. Shoaf*, 815 F.2d 1046, 1049 (5th Cir. 1987) (plan contained a provision expressly releasing a creditor’s claim against a guarantor of the debtor); *In re Digital Impact, Inc.*, 223 B.R. 1, 4 (N.D. Okla. 1998) (plan provided that the debtor’s principal was released from all claims relating to the debtor).

issued by the court, forever prohibiting a creditor from prosecuting its claims against a non-debtor;<sup>182</sup> or (3) both a release and a permanent injunction barring the creditor from attempting to collect from the released party on the extinguished claim.<sup>183</sup> The injunctions in the *Johns-Manville* case enjoining MacArthur and the tort claimants from suing the debtor's insurance carriers fell into the second category. But each type of release has the same basic impact.<sup>184</sup>

Non-debtor releases vary in scope. Some bar a single cause of action held by an individual.<sup>185</sup> Others purport to extinguish *all* of a non-debtor's liabilities.<sup>186</sup> However, third-party releases typically fall somewhere between these two extremes, eliminating all claims against a non-debtor (1) concerning a particular mass tort,<sup>187</sup> or (2) relating to the debtor.<sup>188</sup>

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<sup>182</sup> See, e.g., *Lansing Diversified Props.-II v. The First Nat'l Bank and Trust Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990) (prior to confirmation of the plan, the bankruptcy court entered a permanent injunction enjoining a creditor of the debtor from prosecuting its claim against a non-debtor), *modified*, *Abel v. West*, 932 F.2d 898 (10th Cir. 1991); *Am. Hardwoods, Inc. v. Deutsche Credit Corp. (In re Am. Hardwoods, Inc.)*, 885 F.2d 621, 622 (9th Cir. 1989) (prior to confirmation of the plan, the debtor sought a permanent injunction enjoining a creditor from pursuing a state court lawsuit against guarantors of the debtor's obligation to the creditor).

<sup>183</sup> See, e.g., *In re Dow Corning Corp.*, 255 B.R. 445, 475 (E.D. Mich. 2000) (plan both released certain claims against Dow Corning's shareholders and enjoined holders of the released claims from attempting to recover against the shareholders), *rev'd in part*, 280 F.3d 648 (6th Cir. 2002); *In re Boston Harbor Marina Co.*, 157 B.R. 726, 729, 731 (Bankr. D. Mass. 1993) (plan contained both a release of all claims against the debtor's co-venturers, a former part-owner of the debtor, and an insurance company that was related to the debtor, and a permanent injunction barring prosecution of the released claims).

<sup>184</sup> Like a release, a permanent injunction effectively extinguishes the creditor's claim because the creditor is forever barred from attempting to recover from the non-debtor. See *In re W. Real Estate Fund, Inc.*, 922 F.2d at 600 ("By permanently enjoining [the creditor's] action[s] against [the non-debtor], the bankruptcy court, in essence, discharged [the non-debtor's] liability. . . ."); Meltzer, *supra* note 180, at 4 n.7 (explaining that permanent injunctions and releases have the same effect and thus that the terms will be used interchangeably in the article); Kate Inman, Note, *All Debts Are Off?—Can the Bankruptcy Process Be Used to Release the Debts of Nondebtor Parties*, 49 FLA. L. REV. 631, 633 n.7 (1997) ("A permanent injunction preventing a creditor from suing a third party is, in effect, a discharge of the third party's liability.").

<sup>185</sup> *In re W. Real Estate Fund, Inc.*, 922 F.2d at 598 (bankruptcy court permanently enjoined the debtor's attorney from executing upon a lien against the debtor's bank); *In re Am. Hardwoods, Inc.*, 885 F.2d at 622 (debtor sought a permanent injunction prohibiting a creditor from enforcing a state court judgment against the debtor's shareholder-guarantors).

<sup>186</sup> See, e.g., *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995) (provision in the debtor's plan granted a "global release" of all claims to, *inter alia*, the debtor's children and a business he owned); *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 500 (Bankr. D.N.J. 1997) (Chapter 11 plan stated that "[p]ursuant to § 1141 of the Code, confirmation of this Plan shall also discharge all claims against Debtor's equity Interest holders or Affiliates").

<sup>187</sup> The release in *In re Dow Corning Corp.* prohibits all women injured by Dow Corning's silicone breast implants from suing the company's shareholders for their injuries. 255 B.R. at 475; see also *In re Sybaris Clubs, Int'l, Inc.*, 189 B.R. 152, 153 (Bankr. N.D. Ill. 1995) (provision in the proposed plan of reorganization contained a permanent injunction barring "all persons" from

## 2. The Circuit Split Regarding the Legal Validity of Non-Debtor Releases

The federal courts have long been divided over the propriety of non-debtor releases.<sup>189</sup> Other than § 524(g), the Code does not expressly permit the issuance of such releases.<sup>190</sup> However, “pro-release” courts contend that the general equitable powers granted by §§ 105(a)<sup>191</sup> and 1123(b)(6)<sup>192</sup> allow for this type of relief.<sup>193</sup> Disagreeing, most “anti-release” courts have concluded that non-debtor releases violate § 524(e), which provides that the “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.”<sup>194</sup> They read this language, and the bankruptcy

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prosecuting any action against the debtor’s insiders, a shareholder, and several affiliated entities relating to the sale of notes and debentures issued by the debtor).

<sup>188</sup> The release requested in *In re Digital Impact, Inc.* would have barred anyone from suing the debtor’s principal for any claims related to the debtor. 223 B.R. 1, 4 (Bankr. N.D. Okla. 1998); see also *Deutsche Bank AG v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 141 (2d Cir. 2005) (release in the plan of reorganization purported to extinguish all claims against various corporate insiders related to the debtor or its subsidiaries).

<sup>189</sup> Compare *Hat-Hanseatische Anlage v. Sago Palms Joint Venture* (*In re Sago Palms Joint Venture*), 39 B.R. 9, 9 (Bankr. S.D. Fla. 1984) (holding that § 524(e) bars non-debtor releases), with *In re A.H. Robins Co.*, 88 B.R. 742, 754-55 (E.D. Va. 1988) (holding that courts may grant non-debtor releases pursuant to their “equitable and inherent” power under the Bankruptcy Code), *aff’d*, 880 F.2d 694 (4th Cir. 1989). For a full survey of the split in the courts, see generally Silverstein, *supra* note 6, at 44-90.

<sup>190</sup> *Class Five Nev. Claimants v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 656 (6th Cir. 2002); Silverstein, *supra* note 6, at 17.

<sup>191</sup> Section 105(a) is the primary source of the bankruptcy court’s general equitable powers. See *Johnson v. Home State Bank*, 501 U.S. 78, 88 (1991) (“In addition, the bankruptcy court retains its broad equitable power to ‘issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code.]’” (quoting § 105(a)); *Omni Mfg., Inc. v. Smith* (*In re Smith*), 21 F.3d 660, 665 (5th Cir. 1994) (“From . . . section [105(a)] emanate the general equitable powers of bankruptcy courts.”); *In re G.S.F. Corp.*, 938 F.2d 1467, 1474 (1st Cir. 1991) (observing that § 105(a) grants bankruptcy courts broad equitable powers); 2 COLLIER ON BANKRUPTCY ¶ 105.01, at 105-5 to 105-6 (15th ed. rev. 2004) (“Section 105 . . . is an omnibus provision phrased in such general terms as to be the basis for a broad exercise of power in the administration of a bankruptcy case.”). The statute provides that “[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a) (2006).

<sup>192</sup> Section 1123(b)(6) permits a chapter 11 plan to “include any . . . appropriate provision not inconsistent with the applicable provisions of this title.” 11 U.S.C. § 1123(b)(6).

<sup>193</sup> See, e.g., *In re Dow Corning Corp.*, 280 F.3d at 656-58 (explaining that non-debtor releases are permissible pursuant to §§ 105(a) and 1123(b)(6)); *SEC v. Drexel Burnham Lambert Group, Inc.* (*In re Drexel Burnham Lambert Group, Inc.*), 960 F.2d 285, 293 (2d Cir. 1992) (citing *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 694, 701 (4th Cir. 1989), for the proposition that bankruptcy courts may enjoin litigation against a non-debtor); *In re A.H. Robins Co.*, 880 F.2d at 701 (holding that bankruptcy courts may grant a non-debtor release under § 105(a)); see also Silverstein, *supra* note 6, at 60-61 nn.275 & 276 (containing an extensive list of federal courts and commentators adopting this view); *id.* at 59-61 (more fully outlining the pro-release authorities’ §§ 105(a) and 1123(b)(6) reasoning).

<sup>194</sup> 11 U.S.C. § 524(e) (2006).

policies underlying it, to prohibit third-party releases.<sup>195</sup> Pro-release courts have responded by arguing that § 524(e) does not expressly address releases; therefore, the statute is no bar to such relief.<sup>196</sup> A second group of anti-release authorities

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<sup>195</sup> See, e.g., *Resorts Int'l, Inc. v. Lowenschuss* (*In re Lowenschuss*), 67 F.3d 1394, 1401-02 (9th Cir. 1995) (§ 524(e) prohibits non-debtor releases); *Feld v. Zale Corp.* (*In re Zale Corp.*), 62 F.3d 746, 760 (5th Cir. 1995) (“Section 524[(e)] prohibits the discharge of debts of non-debtors,” and thus § 105(a) may not be used to grant non-debtor releases); *Landsing Diversified Props.-II v. First Nat'l Bank and Trust Co. of Tulsa* (*In re W. Real Estate Fund, Inc.*), 922 F.2d 592, 601-02 (10th Cir. 1990) (holding that § 524(e) prohibits any permanent injunction “extended post-confirmation . . . that effectively relieves the nondebtor from its own liability to the creditor” and thus § 105(a) may not be used to provide such relief); *Am. Hardwoods, Inc. v. Deutsche Credit Corp.* (*In re Am. Hardwoods, Inc.*), 885 F.2d 621, 626 (9th Cir. 1989) (“Section 524(e) . . . limits the court’s equitable power under section 105 to order the discharge of the liabilities of nondebtors.”); see also Silverstein, *supra* note 6, at 47-49 n.194 (containing an extensive list of federal courts and commentators adopting this view); *id.* at 44-50 (describing in greater detail the anti-release authorities’ § 524(e) argument). It is well-established that § 105(a) may not be used in a manner that is inconsistent with another section of the Bankruptcy Code. *Noonan v. Sec’y of Health and Human Servs.* (*In re Ludlow Hosp. Soc., Inc.*), 124 F.3d 22, 28 (1st Cir. 1997) (“The bankruptcy court may not utilize section 105(a) if another, more particularized Code provision . . . impedes the requested exercise of equitable power.”); 2 COLLIER ON BANKRUPTCY ¶ 105.01[2], at 105-7 (15th ed. rev. 2004) (“Section 105 does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code . . .”).

<sup>196</sup> See, e.g., *In re Dow Corning Corp.*, 280 F.3d at 657 (“[Section 524(e)] explains the effect of a debtor’s discharge. It does not prohibit the release of a non-debtor.”); *In re Dow Corning Corp.*, 255 B.R. 445, 477-78 (E.D. Mich. 2000) (“On its face, § 524(e) does not set forth a per se rule prohibiting permanent injunctions as to non-debtors. . . . [The statute] does not expressly prohibit third-party injunctions . . .”), *rev’d in part, aff’d in pertinent part*, 280 F.3d 648 (6th Cir. 2002); *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 936 (Bankr. W.D. Mo. 1994) (“To the extent that § 524(e) does not explicitly prohibit the court from issuing a permanent injunction, the language is clear . . .”); see also Silverstein, *supra* note 6, at 61-62 n.278 (collecting judicial and secondary authorities); *id.* at 61-63 (explaining more fully the pro-release courts’ position regarding 524(e)); *id.* at 122-28 (siding with the pro-release authorities and concluding that § 524(e) does not prohibit non-debtor releases).

A few anti-release authorities have argued that §§ 524(a) and (g) (as opposed to 524(e)) bar non-debtor releases. Regarding § 524(a), compare *In re Am. Hardwoods, Inc.*, 885 F.2d at 622, 626 (ruling that the discharge injunction of § 524(a) “displaces” any authority bankruptcy courts possess under § 105(a) to enjoin the assertion of claims against third parties), and Peter M. Boyle, Note, *Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy*, 61 FORDHAM L. REV. 421, 428-29, 437 (1992) (generally adopting the Ninth Circuit’s argument), with Silverstein, *supra* note 6, at 128-31 (presenting this argument more fully, and then explaining why it is invalid). Regarding § 524(g), compare *In re Lowenschuss*, 67 F.3d at 1402 n.6 (“A recent amendment to the Bankruptcy Code buttresses our conclusion that § 524(e) does not permit bankruptcy courts to release claims against non-debtors.”), and *In re Salem Suede, Inc.*, 219 B.R. 922, 937 (Bankr. D. Mass. 1998) (§ 524(g) “suggests that § 524(e) precludes the issuance” of channeling non-debtor releases), with Silverstein, *supra* note 6, at 50-51 n.204 (rejecting this argument because, *inter alia*, Congress expressly stated that the enactment of § 524(g) was to have no impact on the authority of bankruptcy courts to issue third-party releases), and Ralph Brubaker, *Unwrapping Prepackaged Asbestos Bankruptcies (Part I): Non-Debtor “Releases” and Permanent Injunctions*, 25 No. 1 BANKR. LAW LETTER 1, 7 (2005) [hereinafter Brubaker, BANKR. LAW LETTER]

contend that even if § 524(e) is not an obstacle, §§ 105(a) and 1123(b)(6) simply do not grant sufficient equitable power to permit the release of claims against non-debtors.<sup>197</sup> In a recent article, I sided with the pro-release courts on these issues.<sup>198</sup>

While the pro-release authorities agree that non-debtor releases are permissible, they have used a number of different tests to determine whether a given release is authorized.<sup>199</sup> The now-dominant standard was set forth in *In re Master Mortgage Investment Fund, Inc.*<sup>200</sup> It has five elements. First, there must be “an *identity of interest* between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate.”<sup>201</sup> Second, the third

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(same), Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 111(b), 108 Stat. 4106, 4117 (uncodified) (“Nothing in [524(g)] . . . shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization.”), and 140 CONG. REC. H10765 (daily ed. Oct. 4, 1994) (remarks of Rep. Brooks) (explaining that § 111(b) “make[s] clear that the special rule being devised for the asbestos claim trust/injunction mechanism is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan [of] reorganization.”).

<sup>197</sup> The bulk of these authorities have adopted the position that § 105(a) may only be used to enforce other provisions in the Bankruptcy Code; it does not permit orders implementing general bankruptcy policies such as the policy favoring reorganization over liquidation. Accordingly, since no Code section permits non-debtor releases, § 105(a) cannot be used to grant that form of relief. *See, e.g., In re Digital Impact, Inc.*, 223 B.R. 1, 4-5, 14 (N.D. Okla. 1998) (adopting this reasoning); *In re Dow Corning Corp.*, 244 B.R. 721, 742 (Bankr. E.D. Mich. 1999) (holding that because § 105(a) must be used in conjunction with other Code provisions, the statute does not give bankruptcy courts the power to issue non-debtor releases) *rev'd*, 255 B.R. 445, 480 (E.D. Mich. 2000), *rev'd in part, aff'd in pertinent part*, 280 F.3d 648, 658 (6th Cir. 2002); *In re Sybaris Clubs, Int'l, Inc.*, 189 B.R. 152, 155-56, 159 (Bankr. N.D. Ill. 1995) (same); *see also* Silverstein, *supra* note 6, at 51-52 (setting forth in more detail the anti-release courts' argument with respect to §§ 105(a) and 1123(b)(6)); *id.* at 106-119 (explaining why the anti-release courts' argument is invalid).

Other authorities have suggested that §§ 105(a) and 1123(b)(6) may not be used to contravene substantive non-bankruptcy law, something non-debtor releases clearly do. Brubaker, *supra* note 173, at 1017 n.209 (“[S]upplementary implementation sections such as § 1123(b)(6) merely beg the question whether non-debtor releases are in fact ‘appropriate’ provisions of a plan. That question inevitably requires consideration of the fact that non-debtor releases directly contravene nonbankruptcy law that would impose liability on the released non-debtors.”); *see also* Silverstein, *supra* note 6, at 131 (“[T]hird-party releases . . . eliminate liability that non-debtors would otherwise face under federal and state law.”); *id.* at 131-136 (setting forth this argument in significant detail, and then contending that it is invalid).

For a final anti-release argument based on §§ 105(a) and 1123(b)(6), see *infra* note 229.

<sup>198</sup> *See* Silverstein, *supra* note 6, at 19-20, 106-36.

<sup>199</sup> *Id.* at 71 (“[P]ro-release courts have used various standards to assess the legitimacy of non-debtor releases.”); *id.* at 64-71 (describing the various tests proposed by courts and commentators).

<sup>200</sup> *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994); Silverstein, *supra* note 6, at 64 (explaining that the *Master Mortgage* test is used by a “majority of pro-release courts use in assessing whether to grant a non-debtor release”).

<sup>201</sup> *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. at 935 (emphasis added).

party must *contribute substantial assets* to the reorganization.<sup>202</sup> Third, the release must be “*essential to reorganization*.” Without the [release], there is little likelihood of success.”<sup>203</sup> For example, in the absence of a release, non-debtors may refuse to contribute assets that are “necessary” for the debtor’s reorganization.<sup>204</sup> Fourth, a “substantial majority of the creditors agree to [the release], specifically, the impacted class, or classes has ‘*overwhelmingly*’ voted to accept the proposed plan treatment.”<sup>205</sup> Fifth, the plan provides for “*payment of all, or substantially all, of the claims* of the class or classes affected by the [non-debtor release].”<sup>206</sup> In *In re Dow Corning Corp.*, the Sixth Circuit added a sixth factor: all *dissenting* creditors whose claims are extinguished by the release must be paid in full under the plan.<sup>207</sup> Pro-release authorities have generally approved of this addition.<sup>208</sup>

In my prior article, I argued for a modified version of the *Master Mortgage* test involving four elements.<sup>209</sup> First, an “*identity of interest*” is necessary to establish subject matter jurisdiction over the claims eliminated by the release.<sup>210</sup> Second, the release must be “*essential to the reorganization*” to justify invoking §§ 105(a) and 1123(b)(6).<sup>211</sup> This standard will usually be satisfied by demonstrating that contributions from third parties are necessary to the debtor’s reorganization and are contingent upon the third parties receiving a release.<sup>212</sup> But it can be met in other ways.<sup>213</sup> Thus, the second *Master Mortgage* element—“substantial contribution”—is not required.<sup>214</sup> In addition, the second element of

<sup>202</sup> *Id.*

<sup>203</sup> *Id.* (emphasis added).

<sup>204</sup> *Id.* at 938 (without a release, the non-debtors would not have made contributions that enabled the debtor to formulate a workable plan and allowed creditors to recover in full).

<sup>205</sup> *Id.* at 935 (emphasis added). In *Master Mortgage*, 94.8% and 93.4% of the two classes affected by the release voted for the plan. *Id.* at 938.

<sup>206</sup> *Id.* at 935 (emphasis added).

<sup>207</sup> *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002).

<sup>208</sup> See, e.g., *In re Friedman’s, Inc.*, 356 B.R. 758, 761 (Bankr. S.D. Ga. 2005) (“*Dow Corning* has perhaps the clearest articulation of some of the circumstances in which such a provision can be approved.”) (adopting the *Master Mortgage* test with the *Dow Corning* addition); *In re Transit Group, Inc.*, 286 B.R. 811, 817-18 (Bankr. M.D. Fla. 2002) (also adopting the *Master Mortgage* test with the *Dow Corning* addition).

<sup>209</sup> See Silverstein, *supra* note 6, at 72-78. I shall refer to this as the “Modified *Master Mortgage*” test or elements.

<sup>210</sup> Silverstein, *supra* note 6, at 72; see also *id.* at 20-21 n.38 & 78-79 n.357 (explaining some jurisdictional issues regarding non-debtor releases); *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) (holding that bankruptcy courts have jurisdiction over claims that “could conceivably have any effect on the estate being administered in bankruptcy” (emphasis omitted)).

<sup>211</sup> Silverstein, *supra* note 6, at 72.

<sup>212</sup> *Id.* at 72-73.

<sup>213</sup> *Id.* at 73 (“Alternatively, critical employees of the debtor might refuse to continue working in the absence of a release, making it impossible for the debtor to emerge from bankruptcy and resume its operations.”).

<sup>214</sup> *Id.*

my test mandates that the debtor in fact be reorganizing rather than liquidating.<sup>215</sup> Third, because it is not “fair and equitable” to “cram down” a plan containing a non-debtor release, the class of creditors impacted by the release must have “accepted” the plan under § 1126(c).<sup>216</sup> This is another change from *Master Mortgage* because § 1126(c) provides a different standard (among voting creditors, at least two-thirds in dollar amount and more than one-half in number must approve of the plan) from the fourth element discussed above (“overwhelming” acceptance).<sup>217</sup>

Fourth and last, payment-in-full for *dissenting* creditors whose claims are extinguished by the non-debtor release is required by the best interests of creditors test.<sup>218</sup> Under that test, a Chapter 11 plan of reorganization may only be confirmed if it provides each dissenting, impaired creditor at least as much as the claimant would receive if the debtor liquidated under Chapter 7.<sup>219</sup> Non-debtor releases are impermissible in Chapter 7 cases.<sup>220</sup> In such a proceeding, a creditor may thus recover any deficiency from a solvent co-obligor if the liquidation distribution does not completely satisfy the creditor’s claim.<sup>221</sup> Accordingly, since the dissenting creditor would receive payment in full on its claim in a Chapter 7 bankruptcy from the debtor, the co-obligor, or a combination of the two, the dissenting creditor must receive full payment under the debtor’s Chapter 11 plan if the codebtor receives a release.<sup>222</sup> The same analysis applies if the

<sup>215</sup> *Id.* at 73-74.

<sup>216</sup> Silverstein, *supra* note 6, at 74-75; 11 U.S.C. § 1126(c) (2006) (defining class “acceptance”); *id.* § 1129(b) (establishing that a plan of reorganization may be confirmed over the objection of a dissenting class—i.e., “crammed down”—if the plan is “fair and equitable” and “does not discriminate unfairly”). Claimants impacted by a non-debtor release must be placed in a distinct class (or classes, if the release extinguishes different types of claims). Including them in a class with other claimants “undermines the Bankruptcy Code’s classification and treatment scheme” set forth in 11 U.S.C. §§ 1122(a), 1123(a)(4) (2006). Brubaker, *supra* note 173, at 983; *see also id.* at 981-986 (arguing that third-party releases frequently corrupt the integrity of class formation and treatment because courts do not take the extinguished non-debtor claims into account in analyzing whether the plan of reorganization satisfies §§ 1122(a) and 1123(a)(4)); *id.* at 990-91 (third-party releases weaken the “cram down” protections set forth in § 1129(b) by “infect[ing] the soundness of the classification system”).

<sup>217</sup> Compare 11 U.S.C. § 1126(c) (2006) (“A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan.”), with *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994) (“[A] substantial majority of the creditors agree to [the release], specifically, the impacted class, or classes, has ‘overwhelmingly’ voted to accept the proposed plan treatment.” (emphasis added)).

<sup>218</sup> Silverstein, *supra* note 6, at 76-78.

<sup>219</sup> 11 U.S.C. § 1129(a)(7) (2006); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7], at 1129-45 (15th ed. rev. 2004); *id.* ¶ 1129.03[7][e], at 1129-56 (describing § 1129(a)(7) as restating “the ‘best interests of creditors’ test”).

<sup>220</sup> Silverstein, *supra* note 6, at 73-74 & 76 n.350. *But cf. id.* at 74 n.338 (collecting authorities granting releases in Chapter 11 liquidations).

<sup>221</sup> *Id.* at 76 & n.350.

<sup>222</sup> *Id.* at 77 & n.351.

debtor and the third party are not co-debtors—i.e., where the debtor has no personal liability for the claim against the third party. Clearly, the creditor would receive compensation in full on such a claim from the non-debtor if the debtor liquidated. Thus, when a debtor's Chapter 11 plan purports to extinguish an independent claim against a third party, the best interests test mandates payment in full for the claimholder.<sup>223</sup>

The best interests of creditors test does not apply to creditors voting to accept the plan.<sup>224</sup> Moreover, a release of claims held by such creditors is voluntary and thus legitimate, whether the creditors receive full satisfaction on their claim or not.<sup>225</sup> That is why a plan need not provide payment in full to “all, or substantially all” creditors impacted by a non-debtor release, as mandated by the *Master Mortgage* test.<sup>226</sup> Instead, only dissenting creditors must be paid in full. As a practical matter, however, it is likely that creditors subject to a third-party release would demand equal treatment and object to any plan of reorganization that paid only some of them in full, dooming the release under Element Three—creditor consent. Therefore, plans with non-debtor releases satisfying this fourth element will generally provide payment in full on *all* extinguished claims.<sup>227</sup>

Critically, full payment need not be *guaranteed* to satisfy the best interests test. A plan of reorganization is confirmable as long as the plan is “feasible”—confirmation “is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor.”<sup>228</sup> If the plan obligates the debtor to satisfy the creditor's claim, and the court finds that the plan is feasible, the court may confirm it with the non-debtor release. And upon any default, the creditor must bear the loss because its claim against the third party is gone.<sup>229</sup>

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<sup>223</sup> *Id.* at 77 n.351.

<sup>224</sup> 11 U.S.C. § 1129(a)(7).

<sup>225</sup> See *infra* notes 232-233 and accompanying text.

<sup>226</sup> See *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994).

<sup>227</sup> Silverstein, *supra* note 6, at 78.

<sup>228</sup> 11 U.S.C. § 1129(a)(11). This subparagraph of § 1129(a) is known as the “feasibility requirement.” *Fin. Sec. Assurance, Inc. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship)*, 116 F.3d 790, 801 (5th Cir. 1997).

<sup>229</sup> This point has lead some anti-release authorities to conclude that even if a non-debtor release is part of a Chapter 11 plan that promises payment in full on the extinguished claim, the release is inequitable and thus beyond the power conferred by §§ 105(a) and 1123(b)(6) because it places the risk of plan failure on the *creditor* rather than the non-debtor. Again, if the debtor defaults on its plan obligations—a significant risk—and there is a third-party release, the creditor cannot recover any remaining shortage from the released non-debtor. However, if the plan merely contains a “provisional injunction”—a *temporary*, post-confirmation injunction that expires if the debtor does not satisfy its duty to pay the creditor in full—then the risk of plan failure is allocated to the *non-debtor*. In such a case, the creditor retains its right to sue the previously-shielded third party for any deficiency. The anti-release authorities thus conclude that §§ 105(a) and 1123(b)(6) grant, at most, the power to issue provisional injunctions. See, e.g., *In re Dow Corning Corp.*, 244 B.R. 721, 743 (Bankr. E.D. Mich. 1999), *rev'd*, 255 B.R. 445 (E.D. Mich. 2000), *aff'd in pertinent part*, 280 F.3d 648 (6th Cir. 2002). See generally Silverstein, *supra* note 6, at 80-86 (presenting this argument more fully); *id.* at 119-22 (explaining why the argument is invalid).

Third-party releases that are part of reorganization plans promising payment in full on the barred claims are often referred to as “channeling releases.”<sup>230</sup> Under both the *Master Mortgage* test, as amended by the Sixth Circuit, and my modified version of the test, channeling releases are the only permissible type of non-debtor release. Releases in plans that do not provide for payment in full—known as “actual releases”<sup>231</sup>—are prohibited.

It is crucial to emphasize that, although the authorities are split on the propriety of *channeling* releases, they share a mutual condemnation of *actual* releases. The non-debtor release jurisprudence, bolstered by the arguments of commentators, firmly establishes that third-party releases are either (1) sanctioned only if a feasible plan of reorganization promises full payment on the extinguished claims, or (2) entirely invalid.

### 3. Distinguishing Non-Debtor Releases From Other Types of Relief

Because a “non-debtor release” *extinguishes* a creditor’s claims against a non-debtor *over the creditor’s objection*, the term does *not* refer to: (1) *temporary* limits on lawsuits against non-debtors (either pre- or post-confirmation); (2) releases of claims that are *property of the debtor’s estate*; or (3) releases granted *consensually* by a creditor. Each of these types of relief is distinct from a third-party release.

Going in reverse order, the legitimacy of *voluntary* releases—e.g., reorganization provisions stating that creditors can obtain additional payment from a non-debtor if they agree to release their claims against the third party<sup>232</sup>—is uncontroversial.<sup>233</sup> Similarly, the Code expressly permits the compromise of

<sup>230</sup> Silverstein, *supra* note 6, at 24.

<sup>231</sup> *Id.*

<sup>232</sup> See, e.g., *In re Resorts, Int’l, Inc.*, 145 B.R. 412, 460 (Bankr. D.N.J. 1990) (plan contained provisions enabling creditors to release all claims against several non-debtors in exchange for additional compensation); *In re Monroe Well Serv., Inc.*, 80 B.R. 324, 329 (Bankr. E.D. Pa. 1987) (same).

<sup>233</sup> See *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1046-47 (7th Cir. 1993) (holding that consensual non-debtor releases do not violate § 524(e) and are permissible under the Code); *In re Cent. Jersey Airport Servs., Inc.*, 282 B.R. 176, 182-83 (Bankr. D.N.J. 2002) (holding that a voluntary release does not implicate § 524(e)); *In re Digital Impact, Inc.*, 223 B.R. 1, 14-15 (N.D. Okla. 1998) (holding that bankruptcy courts do not have the power to grant involuntary non-debtor releases, but may issue voluntary third-party releases where such provisions comply with general principles of contract law); *In re Resorts, Int’l, Inc.*, 145 B.R. at 467-68 (permitting voluntary non-debtor releases to be included in the debtor’s plan because such releases are “purely contractual between the parties to the release” and thus do not run afoul of § 524(e)); see also Silverstein, *supra* note 6, 25-26, 26 n.58 (collecting authorities). The courts are split on how consent to a non-debtor release must be shown. According to some, voting in favor of a plan is insufficient to manifest assent; the creditor must expressly sign off on the release. See, e.g., *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 507 (Bankr. D.N.J. 1997). Other courts think a mere vote in favor of a reorganization plan is sufficient. See, e.g., *In re Specialty Equip. Cos.*, 3 F.3d at 1045-47 (holding that a vote for confirmation of the plan is sufficient to indicate acceptance of a voluntary non-debtor release); *In re After Six, Inc.*, No. 93-11150DAS, 1994 WL 45471, at \*1 (Bankr. E.D. Pa. Feb. 9, 1994)

claims *belonging to the estate*.<sup>234</sup> It is thus well-established that bankruptcy courts may override creditor and shareholder rights to assert estate causes of action after the debtor has settled the claims.<sup>235</sup> Pre-confirmation, temporary restrictions on lawsuits against non-debtors—known as “non-debtor stays”—are also generally permissible, if a showing of necessity is made.<sup>236</sup>

Post-confirmation temporary restrictions, while more controversial than voluntary releases, settlements of estate claims, and non-debtor stays,<sup>237</sup> are also distinguishable from third-party releases because they do not *eliminate* the creditor's rights. Known as “provisional injunctions,”<sup>238</sup> these post-confirmation limitations merely (i) suspend the creditor's claim for a specific period of time,<sup>239</sup> or (ii) condition the creditor's right to sue the third party on the debtor's failure to pay the creditor in full through the plan of reorganization.<sup>240</sup> Accordingly, unlike

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(approving of provisions releasing a large number of non-debtors from all claims held by those voting for the plan). For a thorough discussion of consensual non-debtor releases, see generally Meltzer, *supra* note 180, at 33-39.

<sup>234</sup> See, e.g., 11 U.S.C. § 1123(b)(3)(A) (2006) (“[A] plan may . . . provide for . . . the settlement or adjustment of any claim or interest belonging to the debtor or to the estate . . .”).

<sup>235</sup> A good example is shareholder derivative lawsuits. Shareholder derivative claims are actually property of the debtor's estate rather than property of the debtor's shareholders. *Sobchack v. Am. Nat'l Bank & Trust Co. of Chicago (In re Ionosphere Clubs, Inc.)*, 17 F.3d 600, 604 (2d Cir. 1994); *In re Texaco, Inc.*, 84 B.R. 893, 900 (Bankr. S.D.N.Y. 1988), *appeal dismissed* by 92 B.R. 38 (S.D.N.Y. 1988). Accordingly, bankruptcy courts may extinguish shareholders' rights to assert such claims. *In re Ionosphere Clubs, Inc.*, 17 F.3d at 602-04 (affirming an order of the bankruptcy court enjoining the debtor's preferred stockholders from suing certain managers of the debtor for breach of fiduciary duty and tortious interference because the claims were derivative, belonged to the estate, and thus were extinguished as part of a settlement between the debtor and the managers); *In re Pac. Gas and Elec. Co.*, 304 B.R. 395, 418 n.26 (Bankr. N.D. Cal. 2004) (distinguishing authorities holding that § 524(e) proscribes the involuntary release of a creditor's claims against a non-debtor because the release in the debtor's plan of reorganization only extinguished claims belonging to the estate); see also *In re Energy Coop., Inc.*, 886 F.2d 921, 929 (7th Cir. 1989) (“The power of the court under [§ 105(a)] . . . includes the power to issue an injunction enjoining third parties from pursuing actions which are the exclusive property of the debtor estate and are dismissed pursuant to a settlement agreement.”); *In re General Homes Corp.*, 134 B.R. 853, 861 (Bankr. S.D. Tex. 1991) (implying that § 524(e) does not bar releases of derivative claims because § 1123(b)(3)(A) expressly allows for the extinguishing of such claims).

<sup>236</sup> Silverstein, *supra* note 6, at 32-33. Non-debtor stays are typically granted when a creditor's lawsuit against a third party would interfere with the debtor's reorganization. *Id.*

<sup>237</sup> See *id.* at 85-86 n.387 (collecting authorities that are split over the power of bankruptcy courts to issue “provisional injunctions”).

<sup>238</sup> *Id.* at 29; see also *In re Dow Corning Corp.*, 244 B.R. 721, 743 (Bankr. E.D. Mich. 1999) (using the term “provisional injunction” in reference to a hypothetical post-confirmation temporary injunction that would restrain a creditor from pursuing a non-debtor only until the assets available under the plan are exhausted), *rev'd*, 255 B.R. 445, 480 (E.D. Mich. 2000), *rev'd in part*, 280 F.3d 648, 658 (6th Cir. 2002).

<sup>239</sup> See, e.g., *In re Rohnert Park Auto Parts, Inc.*, 113 B.R. 610, 612, 615 (B.A.P. 9th Cir. 1990) (the plan of reorganization restrained creditors from taking legal action against any co-obligors of the debtor for five years).

<sup>240</sup> See, e.g., *In re MAC Panel Co., No. 98-10952C-11G*, 2000 WL 33673757, at \*8 (Bankr. M.D.N.C. Feb. 24, 2000) (the debtor's plan of reorganization included an injunction and a release

channeling releases, provisional injunctions do not place the risk of plan failure on the creditor; the creditor's claims are preserved (though suspended) until payment in full is received. If the debtor defaults, the creditor may pursue the previously shielded third party.<sup>241</sup>

Non-debtor releases must also be distinguished from "exculpation" clauses and injunctions. Non-debtor releases enjoin contract, tort, and statutory claims based on *pre*-petition conduct of the debtor and/or the benefitting non-debtors.<sup>242</sup> Exculpation provisions extinguish causes of action flowing from *post*-petition activities involving the administration of the bankruptcy case—e.g., the filing, negotiation, and confirmation of the reorganization plan.<sup>243</sup> Non-debtor releases and exculpation clauses raise different issues.<sup>244</sup> Indeed, many of the parties protected by exculpations already have qualified immunity from the claims that are barred.<sup>245</sup>

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barring a creditor from prosecuting the debtor's shareholders as long as the debtor complied with the plan, under which the creditor was to be paid in full; any deviation from the plan terminated the injunction and voided the release to the extent a deficiency remained).

<sup>241</sup> See Silverstein, *supra* note 6, at 30. For a summary of an argument against non-debtor releases based on a comparison with provisional injunctions, see *supra* note 229.

<sup>242</sup> See, e.g., *In re Dow Corning Corp.*, 280 F.3d at 653-55 (release extinguished rights of tort claimants against debtor and its shareholders for their pre-petition involvement with silicone breast implants).

<sup>243</sup> See, e.g., *In re Adelpia Commc'ns Corp.*, 368 B.R. 140, 263 & n.290 (Bankr. S.D.N.Y. 2007) (plan included a section entitled "Exculpation" (1) providing that the debtor, its management, the creditors' committees, and numerous other parties "shall not be liable . . . for any Cause of Action arising . . . from actions or omissions in connection with . . . these Chapter 11 Cases, this Plan, the Disclosure Statement," and multiple other pieces of the bankruptcy case, and (2) enjoining "all parties in interest from asserting" such cause of action); *In re Friedman's, Inc.*, 356 B.R. 758, 762 (Bankr. S.D. Ga. 2005) (plan contained a provision stating that the debtor, creditors' committee, lenders, and these parties' directors, officers and other advisors "would be exculpated" from claims by any party of interest in the bankruptcy flowing from an act or omission "arising out of the Debtors' Chapter 11 Cases, negotiation and filing of this Plan, filing the Chapter 11 Cases, the pursuit of confirmation of this Plan, . . . except for their willful misconduct and gross negligence." (quoting the plan of reorganization)).

<sup>244</sup> See *In re Adelpia Commc'ns Corp.*, 368 B.R. at 267 (noting that "without question it has long been the custom in the bankruptcy community to make distinctions between releases involving pre- and post-petition conduct"); *In re Friedman's, Inc.*, 356 B.R. at 760-64 (separately addressing and applying different legal standards to the non-debtor releases and exculpation clauses in the debtor's plan of reorganization). *But see* *Airadigm Communications, Inc. v. FCC (In re Airadigm Commc'ns, Inc.)*, 519 F.3d 640, 647-48, 655-58 (7th Cir. 2008) (analyzing an exculpation clause as though it were a non-debtor release). I think the *Airadigm* court was wrong to proceed as it did.

<sup>245</sup> Section 1103, which sets forth the duties of official creditor committees in bankruptcy and their members, see 11 U.S.C. § 1103(a), (c) (2006), "has been interpreted to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members." *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3d Cir. 2000) (collecting authorities). "This immunity covers committee members for actions within the scope of their duties." *Id.*; accord 7 COLLIER ON BANKRUPTCY ¶ 1103.05[4][a] (15th ed. rev. 2006) ("A member of an official committee has a qualified immunity from legal action for matters relating to the performance of the committee's duties."). But it does not extend to "willful misconduct or ultra vires acts." *In re PWS Holding Corp.*, 228 F.3d at 246; see also *Murphy v. Weathers*, No. 7:07-CV-00027-HL, 2008 WL 4426080,

## B. Non-Debtor Releases Involving Insurance

The channeling injunctions in the *Johns-Manville* case extinguished any rights held by the tort claimants and MacArthur against Manville's insurance carriers. Non-debtor releases of this type, which are not uncommon,<sup>246</sup> raise unique issues because of complexities in the treatment of insurance under both state law and the Bankruptcy Code. This sub-part reviews those issues.<sup>247</sup>

### 1. The Non-Bankruptcy Rights of Co-Insureds and Tort Claimants in a Debtor's Insurance Policy

An insurance policy is a contract between the insurer and the primary insured.<sup>248</sup> "Additional insureds" are persons, other than the primary insured, listed in the policy by name or category as covered insureds.<sup>249</sup> Corporations bankrupted by mass torts frequently own liability policies that provide coverage to multiple additional insureds, including non-debtor affiliates, directors, officers, and shareholders.<sup>250</sup> Additional insureds are third-party beneficiaries of the

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at \*5 (M.D. Ga. Sept. 25, 2008) (explaining that exculpation clauses limited to negligent conduct by the protected parties merely restate the appropriate standard of liability under the bankruptcy code) (collecting authorities).

<sup>246</sup> See, e.g., *Homsy v. Floyd (In re Vitek, Inc.)*, 51 F.3d 530, 531-32 (5th Cir. 1995) (after debtor settled with its liability insurance carriers and the bankruptcy court approved the settlement, the bankruptcy court issued an injunction barring all third parties from suing the insurers for claims seeking additional coverage under the settled policies); *In re Allied Prods. Corp.*, 288 B.R. 533, 535-36, 538 (Bankr. N.D. Ill. 2003) (approving in principle of third-party release of debtor's insurers, which barred claims of debtor's tort creditors against the carriers, but denying the relief because the release was requested as part of a broader motion that was otherwise invalid), *aff'd*, No. 03 C 1361, 2004 WL 635212 (N.D. Ill. Mar. 31, 2004); *In re Dow Corning Corp.*, 198 B.R. 214, 243-47 (E.D. Mich. 1996) (holding that the court possessed the power to grant the debtor's liability carriers a third-party release, extinguishing the rights of debtor's tort claimants against the insurers); *Unarco Bloomington Factory Workers v. UNR Indus., Inc.*, 124 B.R. 268, 272, 276-79 (Bankr. N.D. Ill. 1990) (same); *infra* notes 329, 332, 335 (discussing additional cases involving insurance non-debtor releases); see also Brubaker, *supra* note 173, at 961 (noting that "many" non-debtor releases "are approved in the context of an insurer's settlement of a coverage dispute with the debtor's estate").

<sup>247</sup> In my prior article on non-debtor releases, I presumed that insurance releases were always distinguishable from other types of releases. See Silverstein, *supra* note 6, at 27-28. Additional research has altered my view, as will be apparent below.

<sup>248</sup> *Estate of Sustache v. Am. Family Mut. Ins. Co.*, 751 N.W.2d 845, 850 (Wis. 2008) ("An insurance policy functions as a contract between the insured and the insurer."); 45 C.J.S. *Insurance* § 584 (2007) ("The general rule is that an insurance policy is a personal contract between the insurer and the named insured.").

<sup>249</sup> *House v. State Auto. Mut. Ins. Co.*, 540 N.E.2d 738, 741 (Ohio Ct. App. 1988) (explaining that an additional insured is "any person who is an insured under the policy in addition to the named insured" and that "this includes not only persons who may be indicated by name to be an insured, but also any person who is a member of a class which is specifically indicated to be an insured under the policy."); 45 C.J.S. *Insurance* § 597 (2007) (same).

<sup>250</sup> See 5 COLLIER ON BANKRUPTCY ¶ 541.10[3] at 541-63 (15th ed. rev. 2005) ("The insurance carriers typically have written policies of insurance covering the debtors, nondebtor affiliates and

insurance agreement.<sup>251</sup> As such, they possess contract rights under the insurance policy that are enforceable directly against the carrier.<sup>252</sup>

Once an insurer pays an amount equivalent to the limits set forth in an insurance policy, its obligations under the policy are discharged.<sup>253</sup> If a carrier turns over less than the full policy limit, however, it is only released to the extent of the payment made.<sup>254</sup> Accordingly, absent language in the policy to the

divested predecessor entities, among others.”); 1 ROWLAND H. LONG, *THE LAW OF LIABILITY INSURANCE* § 3.06[3][a] (2007) (“In addition to the named insured, the standard CGL [Commercial General Liability] policy also extends coverage to other individuals.”).

<sup>251</sup> Douglas R. Richmond, *Insurance Agent and Broker Liability*, 40 *TORT TRIAL & INS. PRAC. L.J.* 1, 55-56 (2004) (“Additional insureds are intended third-party beneficiaries of the policies to which they are added.”); Douglas R. Richmond, *The Additional Problems of Additional Insureds*, 33 *TORT & INS. L.J.* 945, 947 (1998) (“Because only the insurer and named insured are parties to the insurance contract, additional insureds necessarily are third-party beneficiaries.”); *see, e.g.*, *Herd v. Am. Sec. Ins. Co.*, 556 F. Supp. 2d 992, 997 (W.D. Mo. 2008) (holding that where two individuals were listed as additional insureds, the insurance policy “clearly and directly expressed . . . intent” that they benefit from the policy, and thus the individuals were third-party beneficiaries).

<sup>252</sup> *See In re Forty-Eight Insulations, Inc.*, 133 B.R. 973, 978 (Bankr. N.D. Ill. 1991) (explaining that MacArthur in *Johns-Manville* and the debtor’s co-insured parent company in this case held legal or equitable interests in the insurance policies at issue “with the right to make direct claims on the insurers if the conditions of the policies are satisfied”), *aff’d*, 149 B.R. 860 (N.D. Ill. 1992); *Cnty. Bank of Homestead v. Am. States Ins. Co.*, 524 So. 2d 1154, 1154 (Fla. Dist. Ct. App. 1988) (“[C]overage to the bank as an ‘additional insured’ . . . afforded the bank the right to maintain an independent action as an intended third-party beneficiary.”). Loss payees on insurance contracts, another type of third-party beneficiary, have similar rights. *See Master Mortgage Inv. Fund, Inc. v. Am. Nat. Fire Ins. Co. (In re Master Mortgage Inv. Fund, Inc.)*, 165 B.R. 453, 455 (Bankr. W.D. Mo. 1993) (“Certainly, a loss payee may bring action against an insurer on the contract of insurance as a third party beneficiary.”); *GMAC v. The Windsor Group, Inc.*, 2 S.W.3d 836, 839-40 (Mo. Ct. App. 1999) (because insurance policy loss payees are third-party beneficiaries, they are entitled to enforce the policy against the insurer; if a party has the right to enforce a contract—either as a party to the agreement or a third-party beneficiary—the party “has a legally protectable interest”). *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 304 (1981) (a third-party beneficiary “may enforce the duty” owed to it by the promisor under an agreement).

<sup>253</sup> *Carolina Cas. Ins. Co. v. Studer*, 555 F. Supp. 2d 972, 978-79 (S.D. Ind. 2008) (depositing policy limits with court via interpleader action extinguished carriers indemnification and defense obligations under the policy to the primary and additional insureds) (applying Illinois and Indiana law); *Hosp. for Joint Diseases v. Hertz Corp.*, 803 N.Y.S.2d 670, 670 (N.Y. App. Div. 2005) (“[W]here . . . an insurer has paid the full monetary limits set forth in the policy, its duties under the contract of insurance cease.” (internal quotation marks omitted)); 4 LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* 3d § 61:9 (1996) (“When the insurer makes payment of the proceeds of insurance to the person who by the policy is the proper recipient, such payment is a discharge of the liability of the insurer.”) (collecting authorities). It should be noted, however, that a majority of courts hold that the *duty to defend* is not always discharged merely by paying the policy limit of a commercial general liability policy. *See* ROBERT H. JERRY, II, *UNDERSTANDING INSURANCE LAW* 876-80 (2002).

<sup>254</sup> *See supra* note 253 (the authorities cited therein implicitly support this conclusion); *see also* 46A C.J.S. *Insurance* § 1986 (2007) (“As a general rule, when the insurer makes payment of the proceeds of insurance to the person who by the policy is the proper recipient, such a payment is a discharge of the liability of the insurer, *where the entire amount due is paid*. In the case of a *partial*

contrary, a compromise between one insured and the insurer cannot extinguish the rights of other insureds to pursue the carrier for any difference between the policy limits and the settlement amount.<sup>255</sup> This conclusion reflects the general principle that a promisor and promisee may not alter a third-party beneficiary's rights without the latter's consent once those rights have vested.<sup>256</sup> A similar rule regarding settlements applies to loss payees,<sup>257</sup> who are also third-party beneficiaries of an insurance agreement.<sup>258</sup>

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payment to the person designated by the policy, the insurer is discharged from liability *to the extent of the amount paid.*" (emphasis added)).

<sup>255</sup> See *In re Forty-Eight Insulations, Inc.* 133 B.R. 973, 979-80 (Bankr. N.D. Ill. 1991) (holding that because the debtor and its carriers reached a settlement for less than the policy limits, FWC, a non-debtor co-insured, still held rights under the policies, and non-bankruptcy law did not permit the court to extinguish those rights) ("When FWC purchased the policies it assumed the risk that the policies might be exhausted by claims made by the additional insureds, not that its rights would be extinguished by a separate agreement between one of the additional insureds and the insurer."), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992); Michael Sean Quinn & Brian S. Martin, *Insurance and Bankruptcy*, 36 TORT & INS. L.J. 1025, 1079-80 (2001) ("[A] subsidiary that has gone into bankruptcy may not compromise the rights under the policy of a co-insured parent[.]"); see also RESTATEMENT (SECOND) OF CONTRACTS § 311 cmt. e (1981) ("In general the power of promisor and promisee to vary the duty to a beneficiary under other types of insurance policies is understood to be subject to a similar limitation: when an insured loss occurs, the power to vary the terms of the policy with respect to that loss is terminated."); *id.* § 311 cmt. e, illus. 5 ("A contracts with B for liability insurance covering any person operating A's automobile with A's permission. C incurs liability covered by the policy. Thereafter A and B agree to rescind the policy. The attempted rescission does not affect the rights of C or the person to whom he is liable."); 46A C.J.S. *Insurance* § 1882 (2007) ("A settlement with respect to one item of loss does not preclude recovery on the policy with respect to other items. Similarly, a settlement and release with respect to one claim does not preclude recovery on the policy with respect to other claims.").

<sup>256</sup> See E. ALLAN FARNSWORTH, *CONTRACTS* § 10.8, at 673 (4th ed. 2004) (noting that "[a]ll courts agree" with this proposition). The authorities differ on the moment of vesting, and have adopted three distinct views: vesting occurs (1) when the contract is formed, (2) when the beneficiary assents to the contract, or (3) when the beneficiary relies upon the contract. *Id.* § 10.8, at 673. But the promisor and promisee are free to override these default rules by expressly identifying the moment of vesting in their agreement. *Id.* § 10.8, at 675.

<sup>257</sup> See *Perfect Invs., Inc. v. Underwriters at Lloyd's, London*, 782 P.2d 932, 934 (Okla. 1989) (holding that a settlement between an insurer and insured cannot defeat a loss payee's rights against the insurer, unless the loss payee consents); 46A C.J.S. *Insurance* § 1884 (2007) ("A loss payee's right to proceed against the insurance company may not be defeated by a settlement between the insured and the insurance company made without the knowledge and consent of the loss payee.").

<sup>258</sup> See *supra* note 252. Additional insureds and loss payees are often (though not always) subject to the carrier's defenses against the insured. See, e.g., *Master Mortgage Inv. Fund, Inc. v. Am. Nat'l Fire Ins. Co. (In re Master Mortgage Inv. Fund, Inc.)*, 165 B.R. 453, 455 (Bankr. W.D. Mo. 1993) ("[T]hird party beneficiaries are . . . subject to the same defenses as the promisor could assert if the promisee were suing on the contract." (citations omitted)) (applying the rule to an insurance contract and the loss payee thereunder). This principle is frequently articulated by describing the third-party beneficiary's rights as "derivative." See, e.g., 45 C.J.S. *Insurance* § 597 (2007) ("The rights of any third party to an insurance contract are derivative rights, however, and can rise to no greater dignity than the rights of the insured under the contract."). But the principle has no bearing here. The authority of a promisor and promisee to modify a contract involving a third-party beneficiary (such as a settlement for less than the policy limits between an insurer and the named

In *Johns-Manville*, MacArthur was an additional insured.<sup>259</sup> Like other such insureds, it possessed “a right directly against the insurers to seek indemnification for product liability based on Manville products,”<sup>260</sup> as long as the policy limits were not exhausted. However, there was some suggestion that Manville’s insurers *had* already paid the full policy limits pursuant to their settlements with the debtor.<sup>261</sup> If that was the case, then MacArthur owned no rights against Manville’s carriers,<sup>262</sup> and the channeling injunction barring MacArthur from suing the insurers did not extinguish anything.<sup>263</sup> If the policy limits were *not* consumed, however, then the injunction did constitute a non-debtor release of MacArthur’s state law contract claims against the carriers for the remaining coverage.<sup>264</sup>

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insured that purports to eliminate the rights of additional insureds) is governed by a different set of rules from those that address which defenses are assertable by a promisor against a third-party beneficiary. Compare FARNSWORTH § 10.8 (“Vulnerability of Beneficiary to Discharge or Modification”), and RESTATEMENT (SECOND) OF CONTRACTS § 311 (1981) (“Variation of a Duty to a Beneficiary”), with FARNSWORTH § 10.9 (“Vulnerability of Beneficiary to Defenses and Claims”), and RESTATEMENT § 309 (“Defenses Against the Beneficiary.”).

<sup>259</sup> MacArthur was added to the policy via a vendor endorsement, *MacArthur Co. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 837 F.2d 89, 90 (2d Cir. 1988), making it an additional insured, *Merced County Mut. Fire Ins. Co. v. State*, 284 Cal. Rptr. 680, 686 (Cal. Ct. App. 1991) (“An additional insured added by endorsement is a third-party beneficiary of the insurance contract[. . .].”). See also Zaretsky, *supra* note 141, at 408 (“MacArthur was, in effect, a co-insured under Manville policies, entitled to indemnification for liability resulting from the sale of Manville products.”).

<sup>260</sup> Zaretsky, *supra* note 141, at 408; see also *In re Forty-Eight Insulations, Inc.* 133 B.R. 973, 978 (Bankr. N.D. Ill. 1991) (explaining that MacArthur had a legal or equitable interest in Manville’s policies), *aff’d*, 149 B.R. 860 (N.D. Ill. 1992).

<sup>261</sup> See *In re Johns-Manville Corp.*, 837 F.2d at 90-91 (“It is disputed whether Manville’s policy limits have been exhausted.”); *id.* at 93 (“In the present case, such a dispute exists because Manville claims that the product liability limits on the policies to which the vendor endorsements attach have been exhausted. The Bankruptcy Judge appears to have substantially accepted Manville’s contention, as he found that MacArthur’s interest in the settled policies was ‘highly speculative.’”).

<sup>262</sup> *Id.* at 90 (“The endorsements are subject to the payment limits and other restrictions of the underlying policies; thus, if the product liability aggregate limits in the underlying Manville policies have been exhausted, the insurer has no independent obligation to pay distributors on product liability claims.”); Zaretsky, *supra* note 141, at 412 (explaining that if Manville used all of the available insurance proceeds, MacArthur would have nothing to pursue); see also *In re Forty-Eight Insulations, Inc.*, 133 B.R. at 980 (observing that if the debtor had already exhausted the insurance, the co-insured non-debtor “may have no further rights under the policies”); *Carter v. State Farm Mut. Auto. Ins. Co.*, 33 S.W.3d 369, 373 (Tex. App. 2000) (“[S]ettlements that result in the exhaustion of policy limits excuse further performance by the insurer on behalf of the other insureds.”).

<sup>263</sup> Actually, MacArthur potentially still held “bad faith” claims against the carriers. See *State Farm Mut. Auto. Ins. Co. v. Murphy*, 348 N.E.2d 491, 494 (Ill. App. Ct. 1976) (noting that an insurer may be liable for bad faith in some circumstances even though the policy limits have been exhausted).

<sup>264</sup> In its discussion of the bankruptcy court’s jurisdiction over MacArthur’s claims against the carriers, the Second Circuit concluded that MacArthur’s contractual rights were “no different” from

The situation with respect to a debtor's tort claimants is more complex. Tort claimants are unsecured creditors.<sup>265</sup> Such creditors hold no interest in any specific piece of the debtor's property prior to obtaining a judgment and attaching a lien via post-judgment process.<sup>266</sup> This principle is applicable to liability insurance. The general rule is that, absent policy language or a statutory provision to the contrary, injured parties hold no interest in their tortfeasor's insurance and thus may not sue the insurance company directly to recover under the policies.<sup>267</sup>

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the tort rights "of the asbestos victims who have already been barred from asserting direct actions against the insurers." *In re Johns-Manville Corp.*, 837 F.2d at 92. For jurisdictional purposes, the court was correct. Bankruptcy courts possess jurisdiction over all claims that "could conceivably have any effect on the estate being administered in bankruptcy." *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984); see also 1 COLLIER ON BANKRUPTCY ¶ 3.01[4][c][ii][B], at 3-22 to 3-23 & n.85 (15th ed. rev. 2004) (noting that the *Pacor* Test "has been adopted by most circuit courts"). And, as the Second Circuit correctly explained, both MacArthur and the tort creditors sought "to collect out of the proceeds of Manville's insurance policies on the basis of Manville's conduct." *In re Johns-Manville Corp.*, 837 F.2d at 92-93 (emphasis added). MacArthur's and the asbestos plaintiffs' claims would thus "effect" the estate, providing the bankruptcy court with jurisdiction over them. See *id.* at 93 ("In both cases, plaintiffs' claims are inseparable from Manville's own insurance coverage and are consequently well within the Bankruptcy Court's jurisdiction over Manville's assets."). But this jurisdictional analysis does not establish any parallel between MacArthur's and the asbestos claimants' rights under state substantive law. Nor is it relevant to whether MacArthur's or the tort plaintiffs' claims constituted or flowed from interests in estate property, an issue discussed *infra* at Part IV.B.2.

<sup>265</sup> See *In re Elec. Mach. Enters., Inc.*, 371 B.R. 549, 552 (Bankr. M.D. Fla. 2007); Edward J. Janger, *The Death of Secured Lending*, 25 CARDOZO L. REV. 1759, 1760 (2004).

<sup>266</sup> *Volvo White Truck Corp. v. Chambersburg Beverage, Inc. (In re White Motor Credit Corp.)*, 75 B.R. 944, 948 (Bankr. N.D. Ohio 1987) ("General unsecured claimants including tort claimants, have no specific interest in a debtor's property."); Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 1023 (2004) ("Under nonbankruptcy law, unsecured creditors have no property interest in their debtor's assets until such time as they receive a judicial lien, normally following judgment and, as to personal property, the exercise of judicial remedies against the debtor's assets.").

<sup>267</sup> 1 LONG, *supra* note 250, § 1.06[3][a], at 1-34.2 ("The modern rule is that, in the absence of a contractual or statutory provision allowing a direct action, the claimant has no right to a direct action against the insurer."); 46A C.J.S. *Insurance* § 1942 (2007) ("As a general rule, in the absence of policy or statutory provisions to the contrary, one who suffers an injury which comes within the provisions of a liability insurance policy is not in privity of contract with the insurance company, and cannot reach the proceeds of the policy for the payment of his or her claim by an action directly against the insurance company."); 22 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2d § 142.1[B][1], at 480 (2003) (explaining that tort claimants are "remitted" to standard post-judgment remedies, such as garnishment, if there is no direct action statute and the claimant is not a third-party beneficiary under the insurance policy); see, e.g., *Trancik v. USAA Ins. Co.*, 581 S.E.2d 858, 861 (S.C. Ct. App. 2003) (explaining that an injured third party is an "incidental beneficiary" and thus "does not have a contractual relationship with the insurer and cannot maintain an action against the insurer for breach of the insurance contract"); *All Around Transp., Inc. v. Cont'l W. Ins. Co.*, 931 P.2d 552, 556-57 (Colo. Ct. App. 1996) ((1) explaining the general rule, (2) noting that Colorado has no general direct action statute and that the injured party was not a third-party beneficiary under the insurance policy, (3) holding that the injured party thus had no direct action rights against the carrier even though it had obtained a judgment against the

If a liability insurance policy provides that persons injured by the insured are third-party beneficiaries, the situation is different. In that circumstance, the harmed parties are in privity of contract with the carrier and may sue the insurer directly,<sup>268</sup> as long as they comply with any conditions set forth in the policy.<sup>269</sup>

Additionally, many jurisdictions have enacted “direct-action” statutes that permit tort claimants to sue the tortfeasor’s carrier directly.<sup>270</sup> “Usually these statutes require the injured party to obtain a final judgment against the insured before proceeding directly against the insurer.”<sup>271</sup> Some of these laws permit a direct suit as soon as the final judgment is entered.<sup>272</sup> Others require either that the judgment remain unpaid for a certain period of time<sup>273</sup> or the existence of a writ of execution that was returned unsatisfied.<sup>274</sup> I shall refer to all such laws

insured, and (4) observing that the injured judgment creditor could use the general garnishment laws to enforce the judgment against the insurer).

There are a number of exceptions to this general rule. Perhaps the most important involves compulsory insurance. See *In re Dow Corning Corp.*, 198 B.R. 214, 239 n.18 (E.D. Mich. 1996) (explaining that Michigan regards injured persons to be third-party beneficiaries of compulsory liability insurance, such as automobile insurance); *Crisp Reg'l Hosp., Inc. v. Oliver*, 621 S.E.2d 554, 583 (Ga. Ct. App. 2005) (“[W]ith the exception of certain instances where liability insurance coverage is *legislatively mandated*,” tort claimants are generally not third-party beneficiaries of liability insurance policies. (emphasis added)); 7A LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* 3d § 104:45 (1997) (noting that a person injured in a car accident is a “legal beneficiary” of the tortfeasor’s “[c]ompulsory motor vehicle insurance.”).

<sup>268</sup> 7A *COUCH ON INSURANCE* 3d, *supra* note 267, § 104:7 (“The absence of privity is no bar to a direct action against a liability insurer where there is a statute *or contract clause* giving the injured person a direct action right.” (emphasis added)); 46A C.J.S. *Insurance* § 1942 (2007) (“Where the insurance contract, by reason of policy provisions for the benefit of the injured person, is construed as a third-party beneficiary contract, the injured person has the usual rights of a third-party beneficiary to maintain an action against the insurance company.”) (collecting authorities); see, e.g., *Underwriters at Lloyds v. Shimer (In re Ide Jewelry Co.)*, 75 B.R. 969, 975-76 (Bankr. S.D.N.Y. 1987) (consignor, injured as a result of consignee-insured’s conduct, possessed a direct right of action against the consignee’s carrier under the consignee’s insurance policy); *Desmond v. Am. Ins. Co.* 786 S.W.2d 144, 146-47 (Mo. Ct App. 1989) (noting that some liability insurance policies contain provisions that grant injured persons third-party beneficiary status and finding that the policy in this case included such a provision).

<sup>269</sup> 46A C.J.S. *Insurance* § 1943 (2007) (“The injured person can recover only under the terms and conditions of the contract, and must comply with the policy provisions conferring the right.”); see, e.g., *St. Paul Ins. Co. v. Rahn*, 641 S.W.2d 276, 278 (Tex. App. 1982) (explaining that an injured person was required to comply with the conditions of its tortfeasor’s insurance policy before bringing a direct action against the carrier).

<sup>270</sup> 22 *APPLEMAN ON INSURANCE* 2d, *supra* note 267, § 142.3[A][1], at 504; 46A C.J.S. *Insurance* § 1944 (2007). For a good overview of direct action statutes, see generally 22 *APPLEMAN ON INSURANCE* 2d, *supra* note 267, § 142.3, at 502-520.

<sup>271</sup> *APPLEMAN ON INSURANCE* 2d, *supra* note 267, § 142.3[A][1], at 504. See generally *id.* §§ 142.1[D], at 484-85, 142.3[A][1], at 504-506 (identifying numerous examples of such statutes).

<sup>272</sup> E.g., CAL. INS. CODE § 11580(b)(2) (West 2005); R.I. GEN. LAWS § 27-7-2 (2008).

<sup>273</sup> E.g., N.Y. INS. LAW § 3420(a)(2) (McKinney 2007); ALA. CODE § 27-32-2 (LexisNexis 2007).

<sup>274</sup> E.g., MICH. COMP. LAWS ANN. § 500.3006 (West 2002); 215 ILL. COMP. STAT. ANN. 5/388 (West 2008).

that condition a direct suit on the existence of a judgment as “*post-judgment* statutes.”

Some direct action laws permit suit against the insurer prior to the entry of a judgment against the tortfeasor.<sup>275</sup> A few even permit a direct action without the filing of a lawsuit against the insured.<sup>276</sup> I shall refer to all such laws as “*pre-judgment* statutes.”

Direct actions laws, whether of the post-judgment or pre-judgment variety, also typically state that the insolvency or bankruptcy of the insured does not release or alter the liability of the carrier.<sup>277</sup>

While some features of direct action statutes are relatively straight-forward, courts in pre-judgment and post-judgment states are divided over (1) whether such laws confer a property interest in liability insurance, (2) the nature of any interest conferred, and (3) when the interest arises.<sup>278</sup> Moreover, it is difficult to ascertain the precise contours of these disagreements because of ambiguities in the case law.<sup>279</sup>

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<sup>275</sup> 22 APPLEMAN ON INSURANCE 2d, *supra* note 267, § 142.3[A][1], at 505 (“Note that some states permit the injured party to maintain an action against the tortfeasor’s insurer at an earlier stage of the proceedings against the tortfeasor.”).

<sup>276</sup> *E.g.*, WIS. STAT. ANN. § 632.24 (West 2006) (“Any bond or policy of insurance covering liability to others for negligence makes the insurer liable, up to the amounts stated in the bond or policy, to the persons entitled to recover against the insured for the death of any person or for injury to persons or property, irrespective of whether the liability is presently established or is contingent and to become fixed or certain by final judgment against the insured.”); Estate of Otto v. Physicians Ins. Co. of Wisconsin, Inc., 751 N.W.2d 805, 812 (Wis. 2008) (“[T]he insured is not a necessary party to the action brought against its insurer.”); LA. REV. STAT. ANN. § 22:1269(B)(1) (2009); *see also* 5 COLLIER ON BANKRUPTCY ¶ 541.10[3], at 541-63 (15th ed. rev. 2005) (“In addition, some allegedly injured persons may have direct action rights against the insurance carrier, even, in some cases, bypassing the debtor-insured.”).

<sup>277</sup> For examples of post-judgment provisions containing such language, see CAL. INS. CODE § 11580(b)(1) (West 2005); N.Y. INS. LAW § 3420(a)(1) (McKinney 2007); MICH. COMP. LAWS § 500.3006 (West 2002); 215 ILL. COMP. STAT. ANN. 5/388 (West 2008); IND. CODE ANN. § 27-1-13-7(a) (West 1999). For examples of pre-judgment laws containing such language, see WIS. STAT. § 632.22 (West 2006) and LA. REV. STAT. ANN. § 22:1269(A) (2009). Virtually every state would have adopted legislation like this “had not insurers revised the standard policy forms used for liability insurance to provide coverage without regard to an insured’s solvency.” ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW 378 (1988).

<sup>278</sup> *See generally* 7A COUCH ON INSURANCE 3d, *supra* note 267, § 104:31 (“The right of a claimant under a direct action statute has been variously described. In some instances, the designation of the nature of the right is not particularly significant while, in others, the implications which could be drawn from the particular classification of the claimant’s right are of the utmost significance.”).

<sup>279</sup> *See id.* § 104:2, at 104-12 to 104-13 (“In the absence of a clear authorizing statute, readers are warned that the analysis of what rights the third party may have against the insurer tends to become tangled in the interwoven strands of various collateral theories, the language and underpinnings of which are themselves often arcane.”). Some of the divergences in the authorities likely flow from variations in statutory language. *See generally id.* § 104:13 (“The statutory schemes of various jurisdictions differ, and practitioners must be certain to review the particular statute of the jurisdiction at issue in order draw definitive conclusions.”).

Authorities in states with *pre*-judgment statutes generally understand such laws to grant tort claimants a property interest in their tortfeasor's liability insurance well before any judgment is obtained against the insured. In Louisiana, for example, the entire public is considered a third-party beneficiary of liability insurance policies<sup>280</sup> with rights that vest "at the time of the tort."<sup>281</sup> And the direct action provision contains language that expressly supports this understanding.<sup>282</sup> In Wisconsin, while tort claimants are apparently *not* third-party beneficiaries,<sup>283</sup> they do obtain a vested interest in the tortfeasor's insurance once a covered injury occurs.<sup>284</sup> Consistent with these principles, decisions applying both Louisiana and Wisconsin law have stated that liability insurance proceeds are reserved for tort claimants—including *pre*-judgment claimants; they are not available to general unsecured creditors.<sup>285</sup>

<sup>280</sup> See *Litton v. Ford Motor Co.*, 554 So. 2d 99, 103 (La. Ct. App. 1989) ("Under the well-established jurisprudence, the general public as a class is also a third party beneficiary of liability insurance coverage.").

<sup>281</sup> See *Hayes v. New Orleans Archdiocesan Cemeteries*, 805 So. 2d 320, 323 (La. Ct. App. 2001) ("The Direct Action Statute vests the injured party with rights at the time of the tort to institute an action directly against the insurer within the terms and limits of the policy.").

<sup>282</sup> See, e.g., LA. REV. STAT. ANN. § 22:1269(D) (2009) ("It is also the intent of this Section that all liability policies within their terms and limits are executed for the benefit of all injured persons and their survivors or heirs to whom the insured is liable[.]") (emphasis added). *But cf.* *Descant v. Adm'rs of Tulane Educ. Fund*, 639 So. 2d 246, 249 (La. 1994) (describing the Louisiana direct action statute as granting "merely . . . a procedural right of action against the insurer").

<sup>283</sup> See *Mercado v. Mitchell*, 264 N.W.2d 532, 538 (Wis. 1978) ("In the absence of express provisions in the policy or statutory provisions which can be read into the policy, a standard liability policy does not make the injured party a third-party beneficiary."); *Hammock v. Koderl*, No. 98-0956-FT, 1998 WL 596401, at \*\*\*1 (Wis. Ct. App. Sept. 10 1998) (same). *But see* *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256, 273 (Wis. 1981) (Abrahamson, J., concurring) (explaining that direct action statutes, among other laws, are "predicated on the theory that the third-party victim is a third-party beneficiary of the insurance contract").

<sup>284</sup> See *Society Ins. v. Capitol Indem. Corp.*, 659 N.W.2d 875, 879 (Wis. Ct. App. 2003) ("Our supreme court clearly indicated that the rights of the parties become fixed when the loss occurs.").

<sup>285</sup> See *Nat'l Union Fire Ins. Co. v. Titan Energy, Inc. (In re Titan Energy, Inc.)*, 837 F.2d 325, 327, 329 (8th Cir. 1988) (explaining that the insurance proceeds will be paid to the *pre*-judgment tort claimant if the policy is valid, but if coverage is lacking then the tort claimant "will join the general creditor queue") (tort claimant filed action against the carrier under Louisiana's direct action statute, LA. REV. STAT. ANN. § 22:1269(B)(1) (2009)); *Hometown Bank v. Acuity Ins.*, 748 N.W.2d 203, 206-07 (Wis. Ct. App. 2008) (explaining that even if an injured person sued the insured in the future and the loss was covered by the carrier, a non-tort judgment creditor of the insured could not garnish the proceeds of the insurance policy because the insurer "would not owe any money to [the insured], but to the injured party"). Some Louisiana authorities consider insurers to be co-liable with the insured to the tort claimant. See, e.g., *Wimberly v. Brown*, 973 So. 2d 75, 78 (La. Ct. App. 2007) ("Further, an insurer is solidarily liable with its insured."); *Yarbrough v. Fed. Land Bank Ass'n of Jackson*, 616 So. 2d 1327, 1335 (La. Ct. App. 1993) ("An obligation is solidary when each obligor is liable for the whole performance of the obligation."). This also strongly suggests that insurance proceeds are preserved for injured persons with claims covered by the policies because only the beneficiaries of a guaranty may recover against the guarantor.

Courts in *post*-judgment jurisdictions are more deeply divided. Some have interpreted their direct action laws as providing injured persons with third-party beneficiary status under the insurance policy once a judgment is obtained against the insured.<sup>286</sup> Tort claimants *without* a final judgment are distinguished and apparently have no property interest in the tortfeasor's liability insurance.<sup>287</sup> Decisions in other states—states that have not fully articulated the status of post-judgment tort creditors—have concurred with this assessment of the rights of pre-judgment claimants.<sup>288</sup>

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<sup>286</sup> See, e.g., *Harper v. Wausau Ins. Co.*, 66 Cal. Rptr. 2d 64, 68 (Cal. Ct. App. 1997) (“[O]nce a party has a final judgment against the insured, the claimant becomes a third party beneficiary of the insurance policy and may enforce the terms which flow to its benefit pursuant to” Cal. Ins. Code section 11580 (West 2005), California’s direct action statute.) (collecting California authorities); *Hand v. Farmers Ins. Exch.*, 29 Cal. Rptr. 2d 258, 266 (Cal. Ct. App. 1994) (“[J]udgment creditors granted a right of action by the [direct action] statute have been repeatedly and definitely held to be third party beneficiaries of the policy.”); see also 22 APPLEMAN ON INSURANCE 2d, *supra* note 267, § 142.1[F], at 491-92 (“Thus, in those states, once a injured party has a final judgment against an insured, the injured party becomes a third party beneficiary of the portions of the policy that flow to his or her benefit.”). Florida also has a post-judgment direct action statute and it implies that injured persons become third-party beneficiaries upon obtaining a judgment against the insured. See FLA. STAT. ANN. § 627.4136(2) (West 2005) (“No person who is not an insured . . . shall have any interest in such policy, either as a third-party beneficiary or otherwise, prior to first obtaining a settlement or verdict against a person who is an insured.”); see also *Canadian Home Ins. Co. v. Norris*, 471 So. 2d 217, 218 (Fla. Dist. Ct. App. 1985) (explaining that upon obtaining a final judgment, the plaintiff vests a “third-party interest” in the insurance policy and may then file a direct action against the carrier under section 627.4136(4)).

<sup>287</sup> See *Hand*, 29 Cal. Rptr. 2d at 265 (“[B]y virtue of section 11580, a judgment creditor of an insured enjoys third party beneficiary status and rights under the policy, and in this respect stands distinct from those ‘third party claimants’ who have not achieved that status.”); *Fortman v. Safeco Ins. Co.*, 271 Cal. Rptr. 117, 119 (Cal. Ct. App. 1990) (“The judgment requirement prevents claimants’ actions unless they first perfect their third-party beneficiary status by securing a judgment against the insured tortfeasor.”); FLA. STAT. ANN. § 627.4136(2) (West 2005) (“No person who is not an insured . . . shall have *any interest in such policy*, either as a third-party beneficiary or otherwise, prior to first obtaining a settlement or verdict against a person who is an insured.” (emphasis added)).

<sup>288</sup> See, e.g., *In re Dow Corning Corp.*, 198 B.R. 214, 240 (Bankr. E.D. Mich. 1996) (applying Michigan law) (“In short, prior to obtaining and enforcing a judgment, an injured person merely has an expectation of recovery that is contingent upon the occurrence of future events, and such expectation does not rise to the level of a vested property right.”) (holding that tort claimants without a judgment against the debtor did not have a property interest in the debtor’s liability insurance); see also *La. World Exposition, Inc. v. Fed. Ins. Co. (In re La. World Exposition, Inc.)*, 832 F.2d 1391, 1399 (5th Cir. 1987) (“One having a pending, unadjudicated tort claim against another does not—whether or not the claimant is bankrupt—thereby have a property interest in liability insurance proceeds payable to the defendant. . . .” (offering the quoted language as a general principle, rather than interpreting any particular direct action statute)); 7A COUCH ON INSURANCE 3d, *supra* note 267, § 104:32 (contending that direct action statutes do not transform a tort claimant from “a mere general creditor” into a secured creditor, but only citing cases from the 1930s).

If an injured person lacks a property interest in its tortfeasor's policy, then his rights are probably the same as those of any other unsecured creditor. Under this conclusion, liability insurance proceeds should not be segregated for tort claimants. Rather, they should be distributed to the full body of unsecured creditors via the bankruptcy priority scheme.<sup>289</sup>

Other post-judgment states take a different view. Courts applying Alabama law, for example, have interpreted the local direct action statute<sup>290</sup> to provide tort claimants with the equivalent of a lien on the tortfeasor's insurance once they suffer harm.<sup>291</sup> Similarly, the Second Circuit read New York's direct action law

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<sup>289</sup> See Charles A. Beckham, Jr., *It's All an Unsecured Claim to Me: The Tortious Interference of Bankruptcy Law with Liability Insurance Proceeds*, 22 TEX. TECH. L. REV. 779, 798 (1991) ("The Bankruptcy Code does not contain a separate priority scheme for the distribution of insurance proceeds. Any distribution of insurance proceeds directly to a tort claimant would be repugnant to the stated intentions of the Bankruptcy Code."); see also WILLIAM L. NORTON, III & ROGER G. JONES, NORTON CREDITORS' RIGHTS HANDBOOK § 20:4 (West 2008) (suggesting that whether tort claimants have priority over other unsecured creditors in insurance proceeds is an open question); Zaretsky, *supra* note 141, at 398 ("[I]f the insurance proceeds are viewed as property of the estate, then arguably the proceeds should be distributed among creditors in the same manner as other property of the estate."). Two commentators have cited *Soliz v. S. Farm Bureau Cas. Co.* (*In re Soliz*), 77 B.R. 93 (Bankr. N.D. Tex. 1987) (decided under the Bankruptcy Act of 1898, Pub. L. No. 696, 30 Stat. 544 (repealed 1978), rather than the Code), as supporting this conclusion. See Beckham, *supra*, at 796-97; Edward F. Donohue, *Impact of Bankruptcy on Insured Malpractice Claims*, 3 No. 2 LEG. MALPRACTICE REP. 11, 12 (1992). In that case, the trustee settled with the debtor's alleged liability insurer. *In re Soliz*, 77 B.R. at 94. The court ultimately held that the money paid by the carrier pursuant to the settlement was property of the estate, "distributable to all creditors in accordance with the applicable Bankruptcy Act provisions," rather than to the tort claimants injured by the debtor. *Id.* at 94-95, 97. However, the payment from the insurer settled, *inter alia*, a number of contract causes of action "unrelated to the claims of the Tort Claimants." *Id.* at 95, 97. And the court distinguished a case cited by the tort claimants on the ground that it concerned "a liability policy, not a contract right dispute as in the instant case." *Id.* at 97. The court appears to have treated the settlement payment not as liability insurance proceeds, but as breach of contract damages. Thus, *Soliz* is questionable authority for the proposition that tort claimants have no priority in liability insurance over unsecured creditors.

<sup>290</sup> ALA. CODE §§ 27-32-1, 27-32-2 (LexisNexis 2007).

<sup>291</sup> See, e.g., *Maness v. Ala. Farm Bureau Mut. Cas. Ins. Co.*, 416 So. 2d 979, 981 (Ala. 1982) ("Under Alabama Law, the injured party acquires a vested interest (secondary) in the nature of a hypothecation of the insured's rights under the policy."), *not followed on other grounds*, *Woodall v. Alfa Mut. Ins. Co.*, 658 So. 2d 369 (Ala. 1995); *Nat'l Surety Corp. v. Sanders*, 301 So. 2d 93, 95 (Ala. Civ. App. 1974) (same); BLACK'S LAW DICTIONARY 759 (8th ed. 2004) ("Hypothecate. To pledge (property) as security or collateral for a debt, without delivery of title or possession."). While injured persons may not actually sue insurance companies until after they have obtained a judgment against the insured, *Maness*, 416 So. 2d at 981-82, "the right of the judgment creditor relates back to the time when his right action arose," *Fleming v. Pan Am. Fire and Cas. Co.*, 495 F.2d 535, 538, 541 (5th Cir. 1974) (emphasis added) (holding that a settlement between insurer and insured taking place after the plaintiff's injury, but prior to a final judgment in the underlying action, did not defeat the plaintiff's vested interest in the insurance policy); see also ALA. CODE § 27-32-1 (providing that "whenever a loss occurs on account of a casualty covered by such contract of insurance, the liability of the insurer shall become absolute" (emphasis added)).

to grant a pre-judgment tort claimant an interest in the liability insurance of its tortfeasor superior to that of the tortfeasor's bankruptcy estate.<sup>292</sup> The court explained that the statute created "in effect a trust fund of the insurance proceeds for the benefit of the injured person"<sup>293</sup> and "was designed by the New York legislature to ensure that injured persons with unsatisfied claims against a bankrupt receive the proceeds of insurance before they enrich the bankrupt's general creditors."<sup>294</sup>

A number of other courts and commentators have reached conclusions consistent with the Alabama and New York authorities without citing any particular direct action statute. Some have determined that only injured parties may be paid with insurance proceeds; general unsecured creditors are not entitled to receive such funds.<sup>295</sup> This suggests that the proceeds of liability insurance are held in the equivalent of a constructive trust for the benefit of tort claimants.<sup>296</sup>

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<sup>292</sup> See *Am. Bank & Trust Co. v. Davis (In re F.O. Baroff Co.)*, 555 F.2d 38, 41-42 (2d Cir. 1977) (construing the predecessor to N.Y. INS. LAW § 3420(a)(1) (West 2007)); see also *Baez v. Medical Liab. Mut. Ins. Co.*, 136 B.R. 65, 68 (S.D.N.Y. 1992) (explaining that, under § 3420(a)(1), "upon filing of a bankruptcy petition, the insured is divested of his interest in the proceeds of the policy to the extent that those proceeds are needed to compensate the injured party, which proceeds at that point vest in the injured party") (holding that a pre-judgment tort claimant, unlike "other unsecured creditors," was entitled to post-petition interest paid out of the debtor's liability insurance proceeds).

<sup>293</sup> *In re F.O. Baroff Co.*, 555 F.2d at 42.

<sup>294</sup> *Id.* at 44. A few subsequent decisions have criticized *Baroff*. See, e.g., *Galecor v. Inst. of London Underwriters*, 729 F. Supp. 1101, 1104 (E.D. Pa. 1990) (contending that the "Second Circuit ignored plain statutory language").

<sup>295</sup> See, e.g., *In re Mahoney Hawkes, LLP*, 289 B.R. 285, 295 (Bankr. D. Mass. 2002) (in reference to the proceeds of the debtor's liability insurance policies, the court explained that the tort claimants "have the right to receive some property of the estate that general unsecured creditors cannot receive"); *Landry v. Exxon Pipeline Co.*, 260 B.R. 769, 786 (Bankr. M.D. La. 2001) (noting that liability insurance proceeds "could not be made available for distribution to the creditors other than those who have claims under the policies"); *id.* at 786 n.62 (contending that if insurance proceeds are property of the estate, they should not be distributed pursuant to the bankruptcy priority scheme because unsecured creditors are "without claims covered by the particular insurance"); 3 *COLLIER ON BANKRUPTCY* ¶ 362.03, at 362-25 (15th ed. rev. 2006) (stating that "policy proceeds are not available to all creditors, and in that sense are different from other property of the estate"); *id.* ¶ 362.07, at 362-85 (15th ed. rev. 2002) (noting that policy proceeds are "available only to creditors with the type of claims covered by the policy"); Robert K. Rasmussen, *Resolving Transnational Insolvencies Through Private Ordering*, 98 MICH. L. REV. 2252, 2269 (2000) ("When a firm files for bankruptcy, the proceeds of insurance policies go directly to the injured claimants, despite their nominal status as unsecured creditors."); see also *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 56 (5th Cir. 1993) ("But under the typical liability policy, the debtor will not have a cognizable interest in the proceed of the policy. Those proceeds will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract."); Beckham, *supra* note 289, at 787 ("Most courts and practitioners assume that insurance proceeds are exclusively for the benefit of the tort claimant.").

<sup>296</sup> See Zaretsky, *supra* note 141, at 398 ("The [insurance] proceeds may be viewed as property that is held in a type of constructive trust that can be reached only by a particular class of creditors, not by creditors generally."). Professor Zaretsky also contends that the insurer is comparable to a

Alternatively, even if general unsecured creditors may be paid with liability insurance, tort claimants hold priority rights in the proceeds akin to those of secured creditors.<sup>297</sup> Under either understanding—tort claimants as constructive trust beneficiaries *or* as secured parties—pre-judgment tort claimants possess a property interest in the debtor’s insurance.<sup>298</sup>

As with additional insureds,<sup>299</sup> it is well-established that if the insurer has already paid the policy limits to the insured, the injured party may not recover from the carrier.<sup>300</sup> When the insurer and insured settle for *less* than the coverage

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guarantor who guaranteed debts only to tort claimants. *Id.* at 388 (“The insurer is similar to a guarantor in that it undertakes the obligation to satisfy a claim against the principle debtor who, in this case, is the insured.”); *id.* at 390 (“As with the guaranty, which is available only to the creditor who is the beneficiary of the guaranty, a claim against an insurer is available only to the beneficiaries of the insurance.”).

<sup>297</sup> See, e.g., *In re Mahoney Hawkes*, 289 B.R. at 288-89, 296 (explaining that the debtor’s unsecured tort claimants “are, in effect, multiple secured creditors having claims against a single fund,” namely, the proceeds of the liability insurance policy); Zaretsky, *supra* note 141, at 388 n.46 (“To the extent that insurance proceeds are available to satisfy their claims, the position of the beneficiary-claimants may be analogized to that of a secured party. There is particular property that is earmarked for the satisfaction of their claims. Moreover, their claims may be fully satisfied notwithstanding that mere general creditors may receive little or nothing.”); David Gray Carlson, *Indemnity, Liability, Insolvency*, 25 CARDOZO L. REV. 1951, 1959 (2004) (explaining that the interest of an injured party in its tortfeasor’s insurance is best understood as a statutory lien).

<sup>298</sup> See UCC § 1-201(35) (2001) (“‘Security interest’ means an interest in personal property.”); *In re White*, 297 B.R. 626, 635 (Bankr. D. Kan. 2003) (“The constructive trust is a legal fiction that adopts the analogy of a trust and declares that a beneficiary owns an equitable interest in property.”). Further support for the conclusion that tort claimants have some type of property interest can be drawn from the cases that permit lifting of the automatic stay so that an injured party may prosecute the debtor in name only in order to recover against the debtor’s carrier. See 3 COLLIER ON BANKRUPTCY ¶ 362.07, at 362-85 (15th ed. rev. 2002) (briefly discussing this line of authority). Lifting the stay for quicker recovery is generally something reserved to secured parties or those who otherwise have an interest in the debtor’s property. See *generally id.* ¶ 362.07 (15th ed. rev. 2002, 2005, 2006) (surveying the bases for lifting the stay, virtually all of which require that the party seeking relief hold an interest in the debtor’s property). Moreover, lifting the stay permits tort claimants to recover from liability insurance free from competition with other creditors. If a tort claimant’s rights are no greater than those of other unsecured creditors, there is little basis for permitting such an extraordinary remedy. See also *In re Allied Prods. Corp.*, 288 B.R. 533, 537-38 (Bankr. N.D. Ill. 2003) (holding that, under Illinois’s post-judgment direct action statute, 215 ILL. COMP. STAT. ANN. 5/388 (West 2008), *pre*-judgment tort claimants hold an interest in a bankrupt-insured’s liability insurance requiring adequate protection before the debtor may compromise the policy by selling it back to the carrier free and clear of the tort claimants’ interest), *aff’d*, No. 03 C 1361, 2004 WL 635212 (“In the court’s view, the weight of authority in Illinois favors the proposition that injured parties do generally have rights in insurance policies, and that such rights vest at the moment of injury.”).

<sup>299</sup> For the rule applicable to additional insureds, see *supra* note 253 and accompanying text.

<sup>300</sup> See *Altadis USA, Inc. v. NPR, Inc.*, 162 F. App’x 926, 929 (11th Cir. 2006) (holding that because the insurer had already paid the insurance proceeds to the insured, the injured party could not recover against the insurer); 7A COUCH ON INSURANCE 3d, *supra* note 267, § 106:12 (“The claimant bringing the direct action is subject to the maximum amount limitation of coverage declared in the policy. That is, the claimant cannot recover more from the insurer than the insured

limits, however, the rights of tort claimants appear to depend on whether they hold a property interest in the insurance. Courts frequently hold that a compromise under the policy limits bars injured persons *without* a property interest from suing the carrier for any remaining coverage, as long as the settlement is not a fraudulent transfer to the insurer subject to avoidance by general creditors.<sup>301</sup> But if the tort claimants *possess* a property interest,<sup>302</sup> then a sub-policy limits compromise generally does *not* extinguish their rights against the insurer; the injured persons remain free to pursue the carrier for the difference between the coverage limits and the settlement amount, whether they obtained their property interest by contract<sup>303</sup> or under a direct action statute, such as New York's<sup>304</sup> or Alabama's.<sup>305</sup>

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might have recovered if the action had been brought by him or her.”) (collecting authorities); 46A C.J.S. *Insurance* § 1943 (2007) (the injured party is “limited to the amount of the policy”).

<sup>301</sup> See, e.g., *Michel v. Am. Fire & Cas. Co.*, 82 F.2d 583, 587-88 (5th Cir. 1936) (reversing trial court's directed verdict and holding that the jury should have addressed whether insured's release of insurer for less than one-sixth of the value of its claim constituted fraudulent transfer as to insured's judgment creditor despite fact that judgment creditor held no interest in policy at time of settlement) (applying Florida law); *In re Dow Corning Corp.*, 198 B.R. 214, 233-42 (Bankr. E.D. Mich. 1996) (carefully reviewing Michigan law and reaching the conclusion that injured parties with unliquidated tort claims have no property interest in the tortfeasor's insurance policies, despite Michigan's post-judgment direct action statute, MICH. COMP. LAWS § 500.3006 (West 2002), but may challenge a settlement between the insured and its carriers under fraudulent transfer law, the same as any other unsecured creditor); *Hartman v. United Heritage Prop. & Cas. Co.*, 108 P.3d 340, 342-43, 346 (Idaho 2005) (upholding a settlement for substantially less than the policy limits that resolved a coverage dispute between the carrier and its insured, and was executed prior to the tort claimant obtaining a judgment against the insured, because tort claimants have no rights in liability policies); *Stonewall Surplus Lines Ins. Co. v. Farmers Ins. Co. of Idaho*, 971 P.2d 1142, 1146 (Idaho 1998) (noting that Idaho has no direct action statute); see also *In re Forty-Eight Insulations, Inc.*, 133 B.R. 973, 978 (Bankr. N.D. Ill. 1991) (“It might be clearer to say simply that tort claimants have no ‘legal or equitable’ interest in the insurance policy in the first place, any more than they do in other property of the estate, so that their property rights are not impaired by a settlement of the debtor's claim to coverage.”). Some states also have enacted statutes that prohibit the insurer and insured from agreeing to retroactively void an insurance policy after an injury to a person that may be covered by the policy. See, e.g., WASH. REV. CODE ANN. § 48.18.320 (West 1999).

<sup>302</sup> To recap, tort claimants possess an interest in their tortfeasor's insurance when they (1) are contractual third-party beneficiaries, see *supra* notes 268-69 and accompanying text, (2) were injured in a pre-judgment state, see *supra* notes 280-85 and accompanying text, (3) were injured in a post-judgment state where the direct action statute is construed to grant an interest pre-judgment, see *supra* notes 290-98 and accompanying text, or (4) were injured in a post-judgment state and have obtained a judgment against the insured and complied with any additional conditions of the local direct action statute, see *supra* note 286 and accompanying text.

<sup>303</sup> See *Phila. Forrest Hills Corp. v. Bituminous Cas. Corp.*, 222 A.2d 493, 494-95 (Pa. Super. Ct. 1966) (holding that a settlement between a tortfeasor and its carrier for less than the policy limits did not bar the plaintiff, who was a third-party beneficiary of the insurance policy, from suing the carrier; the settlement apparently took place before the plaintiff obtained a judgment against the insured).

<sup>304</sup> See *Smith & Wesson v. Birmingham Fire Ins. Co.*, 510 N.Y.S.2d 606, 607-10 (N.Y. App. Div. 1987) (holding that a settlement for less than the policy limits between two insured's and their

carrier, executed before the tort claimant injured by the insureds even sued them, was not binding on the tort claimant, and thus the tort claimant was entitled to summary judgment against the carrier for the full amount of its claim, because recognizing the settlement as binding “would defeat the beneficial purpose of” New York’s post-judgment, direct action law, N.Y. Ins. Law section 3420 (West 2007)) (“A settlement agreement between insurer and insured, made without the participation of the injured third party, should not be given the broad effect of barring the third-party judgment creditor’s rights. Such agreement might readily be collusively entered into between the insurer and its insured.”); *Rushing v. Commercial Cas. Ins. Co.*, 167 N.E. 450, 450 (N.Y. 1929) (Cardozo, C.J.) (direct action filed under the precursor to section 3420) (explaining that tort claimant was not “affected by the compromise” between carrier and insured for less than the policy limits executed while tort claimants action against insured was still pending); *Arida v. Essex Ins. Co.*, 750 N.Y.S.2d 725, 726 (N.Y. App. Div. 2002) (holding that settlement of declaratory judgment action between carrier and insured for less than the policy limits, executed while tort claimant’s lawsuit against the insured was pending, did not bar tort claimant from suing the carrier post-judgment under section 3420).

<sup>305</sup> See *Fleming v. Pan Am. Fire & Cas. Co.*, 495 F.2d 535 (5th Cir. 1974). In that case, Fleming’s cattle were damaged by the insured. *Id.* at 537. While Fleming’s suit was pending, the insured and its carrier settled for less than the policy limits. *Id.* at 538. Fleming subsequently obtained a judgment against the insured for well above the settlement amount and then sued the insurer under Alabama’s direct action statute, which is now codified at Ala. Code sections 27-32-1, 27-32-2 (LexisNexis 2007). *Fleming*, 495 F.2d at 535. The Fifth Circuit explained that the statute provides the injured person with the equivalent of a lien on the tortfeasor’s liability insurance, *id.* at 539-40, and that this interest “relates back” to the moment the injury is suffered, *id.* at 541. Thus, “Fleming having acquired such a lien or vested interest, the insurer could not defeat his right of action by its settlement with the named insured.” *Id.* at 540. And Fleming was free to pursue the carrier for any remaining coverage. *Id.* at 541.

Decisions from other jurisdictions, while not expressly addressing the question, contain language suggesting that a settlement for under the policy limits is not binding on the tort claimant once the claimant obtains a property interest. See, e.g., *In re Allied Prods. Corp.*, 288 B.R. 533, 537 (Bankr. N.D. Ill. 2003) (observing that under Illinois’s post-judgment direct action statute, 215 ILL. COMP. STAT. ANN. 5/388 (West 2008), “a claim covered by a liability insurance policy in Illinois, once pursued to judgment against the insured, must be satisfied *up to the policy limits*” (emphasis added)), *aff’d*, No. 03 C 1361, 2004 WL 635212 (N.D. Ill. Mar. 31, 2004); *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256, 266 (Wis. 1981) (explaining that Wisconsin’s pre-judgment direct action statute, WIS. STAT. ANN. § 632.24 (West 2006), makes an insurer “liable *up to the policy limits*” (emphasis added)); *Reliance Ins. Co. v. Superior Court*, 100 Cal. Rptr. 2d 807, 809 (Cal. Ct. App. 2000) (California’s post-judgment direct action statute, CAL. INS. CODE § 11580(b) (West 2005), “provides that a judgment creditor may proceed directly against any liability insurance covering the defendant, and obtain satisfaction of the judgment *up to the amount of the policy limits*.” (emphasis added)). *But cf.* *Unarco Bloomington Factory Workers v. UNR Indus., Inc.*, 124 B.R. 268, 277 (N.D. Ill. 1990) (holding that even if tort claimants possessed direct action rights against debtor’s carriers, good faith settlement between debtor and the insurers discharged any such rights) (apparently applying Illinois law, but failing to specify whether the hypothetical direct action rights reflected the existence of a property interest or not).

As with additional insureds, see *supra* note 258, tort claimants are generally subject to the carrier’s defenses against the insured. See, e.g., *Ferguson v. Nationwide Prop. & Cas. Ins. Co.*, 218 S.W.3d 42, 55 (Tenn. Ct. App. 2006) (“The rights of any third-party to the insurance contract are derivative rights and can rise to no greater dignity than the rights of the insured under the contract.”); 46A C.J.S. *Insurance* § 1943 (2007) (“The injured person’s rights are no better than those of the insured, however, and the insurance company may assert any defense against the

Enhanced protection for tort claimants with a property interest is consistent with the treatment of other parties in analogous positions. For example, as discussed above, compromises for less than the policy limits do not preclude additional insureds and loss payees from suing the insurer for the remaining coverage because of their status as third-party beneficiaries.<sup>306</sup> Similarly, a number of authorities have concluded that a debtor and a third party who owes the debtor money may not settle the debtor's claim without the consent of a creditor who has already attached a security interest to the third party's obligation and notified the third party of the interest.<sup>307</sup>

Returning now to the *Johns-Manville* case, if the settlement between the debtor and its carriers did not fully exhaust the available proceeds,<sup>308</sup> the channeling injunction probably eliminated the state law rights of some tort claimants—those with a property interest in the policies—to sue Manville's

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injured person which it could assert in a suit by the insured.”). But, also as with additional insureds, see *supra* note 258, the availability of defenses under an insurance contract and the binding effect of a modification of that same contract (such as a settlement) are separate questions governed by different legal principles. See *Rushing v. Commercial Cas. Ins. Co.*, 167 N.E. 450, 450 (N.Y. 1929) (Cardozo, C.J.) (distinguishing the impact of policy defenses from the impact of a settlement between the insured and insured); *Smith & Wesson v. Birmingham Fire Ins. Co.*, 510 N.Y.S.2d 606, 608 (N.Y. App. Div. 1987) (same); see also *Fleming*, 495 F.2d at 541 & n.10 (applying Alabama law) (noting that while tort claimants are subject to a carrier's defenses against the insured arising before any injury, “grounds of defense sought to be created by the insurer subsequent to the accident,” such as a settlement between the carrier and the insured, “would not be available” in a proceeding under Alabama's direct action statute, Ala. Code §§ 27-32-1, 27-32-2 (LexisNexis 2007)).

<sup>306</sup> See *supra* notes 254-58 and accompanying text.

<sup>307</sup> See *4447 Assocs. v. First Sec. Fin.*, 889 P.2d 467, 468-70, 475 (Utah Ct. App. 1995) (holding that a settlement between the debtor and a third-party obligor, entered into after the debtor had assigned its rights to a creditor as security and after the creditor had notified the third party of the assignment, was not binding on the creditor), *appeal after remand*, 973 P.2d 992 (Utah Ct. App. 1999); *Progressive Design, Inc. v. Olson Bros. Mfg. Co.*, 206 N.W.2d 832, 833-34 (Neb. 1973) (same) (“As assignee [sic] of the contract, any settlement made by plaintiff [the debtor] is necessarily ineffective unless the assignee [the secured creditor] is a party to it.”); 9 RONALD A. ANDERSON & LARRY LAWRENCE, *ANDERSON ON THE UNIFORM COMMERCIAL CODE* § 9-318:8 (1999) (“Similarly, after an assignment has been made, the assignor [the debtor] cannot settle the claim against the account debtor [the third party] without the consent of the assignee [the secured party].”). See generally *Okla. Natural Gas v. Apache Corp.*, 124 F. App'x 604, 608 (10th Cir. 2005) (applying Oklahoma law) (holding that settlement agreement between assignor and buyer of gas well did not alter rights of assignee of gas well who was not party to agreement and where agreement listed gas well as “previously transferred”); *Cent. Ohio Receivables Co. v. Huston*, No. 87AP-1185, 1988 WL 99356, at \*2 (Ohio Ct. App. Sept. 20, 1988) (“Similarly, an assignor generally lacks the power to discharge the obligor, whether by affirmative action or by default, after the obligor has received notice of the assignment.”). It should be noted that modification of an account post-assignment or post-notification is permitted in some circumstances. See generally U.C.C. § 9-405(a) & (b) (1999); *4447 Assocs.*, 889 P.2d at 475 n.11 (“The account debtor and the assignor are free to make changes as provided by the original account contract or which may be commercially reasonable within the context of the transaction.”).

<sup>308</sup> See *supra* notes 261-64 and accompanying text.

insurers for any remaining coverage. Thus, the injunction operated as a non-debtor release.

Third-party releases extinguish a creditor's *independent* rights against the shielded non-debtor.<sup>309</sup> The analysis in this subpart indicates that additional insureds and some tort claimants hold independent property interests in the debtor's insurance, thereby providing them with such rights against the carrier. Thus, any bankruptcy order barring these additional insureds and tort claimants from suing the carriers—when the coverage has not been exhausted—constitutes a third-party release.<sup>310</sup> However, whether *insurance* non-debtor releases should be governed by the same legal principles as such releases *generally* turns on the relationship of the debtor's insurance to the bankruptcy estate. It is to that issue I now turn.

## 2. Insurance Policies and Proceeds in Bankruptcy

A debtor's insurance policies are generally considered estate property.<sup>311</sup> The most persuasive reason for this conclusion is that the debtor holds title to the insurance policies it purchased.<sup>312</sup> "Since the debtor is the owner of the policy, the policy becomes property of the estate."<sup>313</sup> The debtor's insurance policies are thus shielded by the automatic stay, prohibiting the insurers from cancelling them after the debtor files for bankruptcy.<sup>314</sup>

Critically, ownership of an insurance *policy* is not the same as ownership of or entitlement to the *proceeds* of that policy. "The interest in the policy does not

<sup>309</sup> See *supra* Parts IV.A.1. & IV.A.3.

<sup>310</sup> Cf. *Homsy v. Floyd (In re Vitek, Inc.)*, 51 F.3d 530, 531-32 (5th Cir. 1995) (bankruptcy court granted debtor's carriers a non-debtor release barring all third parties (including additional insureds and tort claimants) from suing them; as part of their settlements with the debtor, the insurers paid the *full* policy limits into the estate).

<sup>311</sup> 3 COLLIER ON BANKRUPTCY ¶ 362.03, at 362-24 (15th ed. rev. 2005) ("The prevailing view is that an insurance policy is property of the estate, protected by the automatic stay.") (collecting authorities); see also 11 U.S.C. § 541(a)(1) (2006) (providing that a debtor's estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case," with minor exceptions).

<sup>312</sup> See *Landry v. Exxon Pipeline Co.*, 260 B.R. 769, 793 n.74 (Bankr. M.D. La. 2001) (liability insurance policies are property of the estate because "of the debtor's contractual rights and ownership interests under and in the policies"); Zaretsky, *supra* note 141, at 385 ("The debtor certainly has a legal interest, title, in the insurance policy itself").

<sup>313</sup> Zaretsky, *supra* note 141, at 385; see also 5 COLLIER ON BANKRUPTCY ¶ 541.10[1], at 541-67 (15th ed. rev. 2005) (explaining that insurance policies "as a whole" belong to the estate "because the corporation owns and pays for the policies").

<sup>314</sup> 3 COLLIER ¶ 362.03, at 362-24. Any rights the debtor holds under its policies are estate property as well. *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 55 (5th Cir. 1993) ("Any rights the debtor has against the insurer, whether contractual or otherwise, become property of the estate."); 5 COLLIER ON BANKRUPTCY ¶ 541.10[1], at 541-60 & n.1 (15th ed. rev. 2006) ("Insurance policies and debtors' rights under insurance policies have been generally held to be property of the estate.") (collecting authorities).

by itself give the debtor any direct right to the proceeds.”<sup>315</sup> Therefore, whether insurance proceeds are property of the estate is a distinct issue from whether the underlying policy belongs to the estate.<sup>316</sup> And the status of policy proceeds can vary with the facts of each case.<sup>317</sup>

When the debtor is both the insured and the loss payee, as in the case of fire, life, and much automobile coverage, there is little question that both the insurance policy *and* the related proceeds are estate property.<sup>318</sup> But the courts are split over whether the proceeds of *liability* insurance are property of the estate.<sup>319</sup>

Some decisions have held that liability insurance proceeds are not estate property because the debtor has no right to keep the proceeds when the insurer pays on a claim.<sup>320</sup> “The proceeds are paid to the victim of the insured’s wrongful act.”<sup>321</sup> The debtor thus has no “cognizable interest” in the proceeds.”<sup>322</sup>

Other cases have found that liability insurance proceeds are generally property of the estate.<sup>323</sup> Some have justified this conclusion on the ground that

<sup>315</sup> Zaretsky, *supra* note 141, at 386; *accord* 5 COLLIER ¶ 541.10[1], at 541-60 & n.1 (“[O]wnership of an insurance *policy* does not necessarily entail entitlement to receive *proceeds* of that policy.” (emphasis in original)).

<sup>316</sup> See *La. World Exposition, Inc. v. Fed. Ins. Co. (In re La. World Exposition, Inc.)*, 832 F.2d 1391, 1399 (5th Cir. 1987) (“The question is not who owns the policies, but who owns the liability proceeds.”); *Landry*, 260 B.R. at 785 (“While the rights held by a debtor under insurance policies are property of the estate, whether the funds paid by the Insurers on account of the insurance policies are property of the estate is an entirely different question.”). *But see* *Homsy v. Floyd (In re Vitek, Inc.)*, 51 F.3d 530, 534 n.17 (5th Cir. 1995) (explaining that “the vast majority of courts do not bother to distinguish ownership of insurance policies from ownership of the proceeds of those policies, but treat that the two go hand-in-hand”).

<sup>317</sup> *In re Sfuzzi, Inc.*, 191 B.R. 664, 668 (Bankr. N.D. Tex. 1996) (“[I]nsurance *policies* are property of the estate . . . , but the question of whether the *proceeds* are property of the estate must be analyzed in light of the facts of each case.” (emphasis in original)); *accord In re Scott Wetzel Servs., Inc.*, 243 B.R. 802, 804 (Bankr. M.D. Fla. 1999).

<sup>318</sup> *In re Sfuzzi, Inc.*, 191 B.R. at 668 (“Unquestionably, proceeds from collision, life, and fire insurance policies are property of the estate when the proceeds are made payable to the debtor rather than to a third party, such as a creditor.”); *accord Landry*, 260 B.R. at 789.

<sup>319</sup> See *Landry*, 260 B.R. at 784-94 (containing an extensive discussion of the split).

<sup>320</sup> See *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 55-56 (5th Cir. 1993) (“The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim.”); *Landry*, 260 B.R. at 786-87 (adopting the *Edgeworth* analysis); *In re Scott Wetzel Serv., Inc.*, 243 B.R. at 804 (same); see also *Landry*, 260 B.R. at 800 (“There is no statutory basis for concluding that the proceeds of liability insurance policies are property of the estate.”).

<sup>321</sup> *Landry*, 260 B.R. at 786.

<sup>322</sup> *In re Edgeworth*, 993 F.2d at 56; *accord Landry*, 260 B.R. at 786 (“In the liability insurance context the debtor has no cognizable claim to the proceeds paid by an insurer on account of a covered claim.”); Zaretsky, *supra* note 141, at 387 (“[T]he debtor does not have any direct interest in the policy proceeds, nor does the debtor have any control over the allocation of the proceeds.”).

<sup>323</sup> See, e.g., *Tringali v. Hathaway Mach. Co., Inc.*, 796 F.2d 553, 560 (1st Cir. 1986) (holding that the proceeds of liability insurance policies are property of the estate).

the debtor's "estate is worth more with [the insurance proceeds] than without them."<sup>324</sup>

Still other decisions have ruled that the status of liability insurance proceeds depends on the type of coverage provided by the policy—namely, whether the policy covers the debtor. If the debtor purchases a liability insurance policy that indemnifies *only* its directors and officers (i.e., the company is not itself an insured under the policy) the proceeds are *not* part of the estate, according to this line of authority.<sup>325</sup> If the policy provides coverage solely to the debtor, however, then the proceeds *are* estate property.<sup>326</sup> Finally, when the policy covers the debtor and third parties, the courts in this line are divided. Some conclude that *all* of the proceeds are part of the estate.<sup>327</sup> Others have ruled that only the debtor's interest in the proceeds are estate property; neither the rights of co-insureds nor the property from which they seek payment are part of the estate.<sup>328</sup>

The bankruptcy status of insurance proceeds is critical to assessing the validity of insurance non-debtor releases. Recall the primary factual scenario involving this type of release. The carrier and the debtor enter into a settlement in which the insurance policy and all related rights are transferred back to the carrier in exchange for a payment to the debtor that is *less than the policy limits* (and less than the value of the claims held by any tort plaintiffs and/or additional

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<sup>324</sup> Nat'l Union Fire Ins. Co. v. Titan Energy, Inc. (*In re Titan Energy, Inc.*), 837 F.2d 325, 329 (8th Cir. 1988).

<sup>325</sup> See, e.g., La. World Exposition, Inc. v. Fed. Ins. Co. (*In re La. World Exposition, Inc.*), 832 F.2d 1391, 1399-1401 (5th Cir. 1987) (holding that officer and director liability policies were property of the estate, but that the proceeds were not because the officers and directors were the only insureds and the proceeds were payable only to them); Homsy v. Floyd (*In re Vitek, Inc.*), 51 F.3d 530, 535 (5th Cir. 1995) (following *In re La. World Exposition*).

<sup>326</sup> *In re Vitek, Inc.*, 51 F.3d at 535.

<sup>327</sup> See, e.g., *In re CyberMedica, Inc.*, 280 B.R. 12, 14, 17 (Bankr. D. Mass. 2002) (holding that all proceeds of the insurance policy were part of debtor's estate even though the policy provided primary coverage to both the debtor and its directors and officers); *In re Sacred Heart Hosp.*, 182 B.R. 413, 420 (Bankr. E.D. Pa. 1995) (reaching the same conclusion under similar facts as *CyberMedica* because the "Proceeds available for the Debtor's liability exposure are not segregated from the Proceeds available to the directors and officers" and thus the Debtor "has a sufficient interest in the Proceeds as a whole to bring them into the estate.").

<sup>328</sup> For example, in *In re Adelpia Communications Corp.*, 364 B.R. 518 (Bankr. S.D.N.Y. 2007), the court found that the co-insured directors and officers "have no interest, disputed or otherwise, in the Estate's Policies, nor to the Estate's entitlement to policy proceeds." *Id.* at 527. It conceptualized the relationship between the carriers, the debtor, and the additional insureds as follows: the estate has claims against the insurers and the co-insured managers have claims against the insurers. *Id.* Thus, the directors and officers "right to any cash would be from the *Insurers*, as a contractual entitlement, not from the property [of the estate] being sold, as a kind of *in rem* right, and would be independent of anything the Estate sought or received." *Id.*; see also *In re Forty-Eight Insulations, Inc.* 133 B.R. 973, 977 (Bankr. N.D. Ill. 1991) (holding that only the debtor's interests in policy proceeds were property of the estate; the co-insured's "claims against the insurers or its interests in the insurance policies are not property" of the debtor's estate), *aff'd*, 149 B.R. 860, 863 (N.D. Ill. 1992) ("The bankruptcy court correctly distinguished, however, the rights of the debtor from the rights of FWC [the co-insured]. Only Forty-Eight's interests are part of the estate. FWC's interest in insurance policies is not part of the estate.").

insureds). Subsequently, the bankruptcy court enters an order releasing *all* claims against the insurer relating to the compromised policy, an order which purports to extinguish the rights of co-insureds and tort plaintiffs to pursue the insurer for the remaining coverage.<sup>329</sup>

Consider first the propriety of an insurance non-debtor release like this when only the *debtor's* rights in the proceeds are part of the estate; the proceeds rights of *additional insureds* and *tort claimants* neither constitute, nor flow from, interests in estate property. Under this legal conclusion, additional insureds and tort plaintiffs hold contractual or statutory claims against the insurer that are *distinct* from the estate. A release discharging these causes of action is indistinguishable from the standard non-debtor release. Therefore, an insurance release is permissible only if it comports with the law *generally applicable* to third-party releases. In pro-release jurisdictions, the release must satisfy the *Master Mortgage* test<sup>330</sup> (or, I would argue, my modified version of the test<sup>331</sup>).<sup>332</sup> If it does, the court may enter the release under §§ 105(a) and/or 1123(b)(6). In anti-release jurisdictions, an insurance release is void,<sup>333</sup> lawsuits by co-insureds

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<sup>329</sup> This is substantially the structure proposed in *In re Adelpia Communications Corp.*, 364 B.R. at 520-21, 523, and *In re Dow Corning Corp.*, 198 B.R. 214, 219-20, 223-24 (Bankr. E.D. Mich. 1996).

<sup>330</sup> See *supra* notes 200-08 and accompanying text (discussing the *Master Mortgage* elements).

<sup>331</sup> See *supra* notes 209-29 and accompanying text (discussing the Modified *Master Mortgage* elements).

<sup>332</sup> The bankruptcy of Adelpia is an excellent example. As noted previously, that case mirrors the primary factual scenario involving insurance non-debtor releases. See *supra* note 329. *Adelpia* was pending in the Southern District of New York, see 364 B.R. 518, which is part of the Second Circuit, a pro-release jurisdiction, see *SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992). The bankruptcy court concluded that the directors' and officers' rights to the liability insurance proceeds were not interests in estate property, but rather were independent claims against the carriers. *In re Adelpia Commc'ns Corp.*, 364 B.R. at 527. The court then proceeded to apply the *Master Mortgage* test to the proposed release. *Id.* at 528-30 (concluding that, since the Test was not satisfied, the court lacked the power to release the directors' and officers' claims against the insurer for the remaining coverage).

*In re Forty-Eight Insulations, Inc.*, 133 B.R. 973, *aff'd*, 149 B.R. 860 (N.D. Ill. 1992), is also instructive. Like *Adelpia*, the facts were consistent with the primary factual scenario. See *id.* at 975-76 (outlining the settlement between the debtor and its carriers and the impact of the release on the debtor's parent company, FWC, a co-insured under the insurance policies subject to the compromise); *id.* at 980 ("[T]he amount of the settlement here is less than the face amount of the policies, so that it is impossible to say that this settlement would exhaust the policies."). The bankruptcy court held that only the debtor's interest in the insurance policies were estate property. *Id.* at 977, *aff'd*, 149 B.R. at 863 (expressly approving of this finding). It subsequently concluded that releasing FWC's rights against the carriers was impermissible. *Id.* at 978. In reaching this determination, the court distinguished several early pro-release cases by noting that (1) Forty-Eight Insulations was liquidating rather than reorganizing, (2) FWC's claims would not lead to contribution or indemnity claims against the debtor, and (3) FWC was not guaranteed full payment on its claims. *Id.* at 978. Each of these bases would eventually become an aspect of the *Master Mortgage* test. See *supra* notes 200-08 and accompanying text.

<sup>333</sup> See *supra* notes 194-97 and accompanying text (discussing the anti-release line of authority).

and tort creditors against the carrier may not be enjoined in these territories when the insurer and the debtor settle for less than the policy limits.

Now consider the legitimacy of an insurance release when *all of the proceeds* payable under the policy are property of the estate. Pursuant to this legal conclusion, the additional insureds' and tort claimants' rights to proceeds—the rights enabling them to bring suit against the debtor's carrier—are essentially *interests in estate property*. This changes the analysis. *First*, if all insurance proceeds are property of estate, there are statutes beyond §§ 105(a) and 1123(b)(6) that may authorize insurance non-debtor releases. Sections 363(f), 1123(a)(5)(D) and 1129(b)(2)(A)(ii) expressly allow for the disposition of estate property free of third-party interests.<sup>334</sup> These statutes *might* authorize a debtor to transfer its insurance policy (and any related rights) back to the carrier *free of the interests of co-insureds and tort claimants*.<sup>335</sup> After such a transaction, the

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<sup>334</sup> See 11 U.S.C. § 363(f) (2006) (“The trustee may sell property . . . *free and clear of any interest* in such property of an entity other than the estate, only if . . . .” (emphasis added)); *id.* § 1123(a)(5)(D) (permitting “sale of all or any part of the property of the estate, either subject to *or free of any lien*” (emphasis added)); *id.* § 1129(b)(2)(A)(ii) (providing that secured claims receive fair and equitable treatment when the plan provides “for the sale . . . of any property that is subject to the liens securing such claims, *free and clear of such liens*, with such liens to attach to the proceeds of such sale” (emphasis added)). The fact that the transfer of the insurance policies is a “settlement” rather than a “sale” is irrelevant. See *In re Adelphia Commc'ns Corp.*, 364 B.R. at 526 (“A sale incident to a settlement is still a sale even if the Insurers are in a unique position to make the purchase, and even if there are no other bidders with the ability or motivation to do so.”); *In re Dow Corning Corp.*, 198 B.R. at 245 (holding that “[e]quating compromises/settlements of lawsuits to sales of a debtor’s property is appropriate because there is so little to distinguish them”); *id.* at 245-47 (offering multiple, persuasive arguments for the conclusion that sales and settlements are essentially the same for purposes of § 363, including § 363(f)). *But see* 3 COLLIER ON BANKRUPTCY ¶ 363.02, at 363-11 (15th ed. rev. 2005) (noting that “the cases are mixed . . . on whether the settlement of a claim that the estate owns is a sale (that is, disposition) of property of the estate”).

<sup>335</sup> *In re Allied Prods. Corp.*, 288 B.R. 533 (Bankr. N.D. Ill. 2003), *aff'd*, No. 03 C 1361, 2004 WL 635212 (N.D. Ill. Mar. 31, 2004), supports this conclusion with respect to § 363(f). That case also appears to follow the primary factual scenario: The debtor wanted to sell its insurance policies back to the carriers and have the court enjoin the debtor’s pre-judgment tort claimants from suing the insurers. *Id.* at 535; *see also id.* at 538 n.2 (implying that the sales price was below the coverage limits of the various policies). The court noted that the insurance policies were property of the estate and thus the debtor possessed the power to sell them. *Id.* at 535-36. The court also explained that the policies could be sold under § 363(f) free and clear of any third-party property interests as long as the interest-holders received adequate protection. *Id.* at 536. The debtor intended to use the proceeds of the sale for the general benefit of the estate, not to pay claims covered by the policies. *Id.* at 535. And the debtor proposed no other form of adequate protection for the tort claimants. *Id.* at 536; *see infra* note 336 for more on adequate protection. Thus, the “buy-back arrangement”—which included the sale of the policies, the injunction shielding the carriers, and the debtor’s use of the proceeds for general purposes—was permissible only if the tort claimants held no property interests in the policies. *In re Allied Prods. Corp.*, 288 B.R. at 536. However, the court ruled that, under Illinois’s post-judgment direct action statute, 215 Ill. Comp. Stat. Ann. 5/388 (West 2008), the pre-judgment tort claimants *did* possess property interests in the debtor’s liability insurance. *In re Allied Prods. Corp.*, 288 B.R. at 537-38. The court thus refused to approve of the buy-back arrangement.

additional insureds' and tort plaintiffs' claims would probably attach to the funds the insurer paid in exchange for the return of the policy.<sup>336</sup> But the additional insureds' and tort claimants' interests *in the insurance policy itself* would be gone, and thus so would their contractual and statutory rights against the insurer for the difference between the settlement amount and the policy limits. Since the co-insureds and tort claimants would now only hold rights in the settlement payment, the bankruptcy court would possess ample authority to enjoin them from suing the insurer.<sup>337</sup>

*Second*, if all liability insurance proceeds are estate property, then insurance third-party releases are probably not subject to the limits on *general* non-debtor releases contained in the *Master Mortgage* test or my modified version of the test. For example, § 363(f) is one possible basis for insurance releases when all of the insurance proceeds are part of the estate. Bankruptcy trustees may use that statute in Chapter 7 cases.<sup>338</sup> Insurance releases might therefore be permissible in Chapter 7 actions,<sup>339</sup> unlike *general* non-debtor releases.<sup>340</sup> This would

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The crucial point here is that *Allied Products* supports the proposition that, because insurance policies are property of the estate, the policies may be sold pursuant to § 363(f) free and clear of the property interests of tort claimants. The problem with the debtor's scheme in *Allied Products* was merely the lack of adequate protection for the tort claimants, not any absolute prohibition on selling insurance policies free and clear of tort claimant property interests.

It should be noted that there is authority that implicitly contradicts *Allied Products*. See *In re Mahoney Hawkes, LLP*, 289 B.R. 285, 290, 295, 300-01 (Bankr. D. Mass. 2002) (concluding that all of the proceeds of the debtor's liability insurance policies were property of the estate, but assessing the insurance non-debtor release in the plan of reorganization under § 105(a) and the *Master Mortgage* test, rather than under § 363(f) or the provisions of Chapter 11 identified *supra* note 334).

<sup>336</sup> See 11 U.S.C. § 363(e) (“[O]n request of an entity that has an interest in property . . . sold . . . by the trustee, the court . . . shall prohibit or condition such . . . sale . . . as is necessary to provide adequate protection of such interest.”); 3 COLLIER ON BANKRUPTCY ¶ 363.06[9] (15th ed. rev. 2005) (“The most common form of adequate protection is to have the lien or other interest attach to the proceeds of the sale.”); 11 U.S.C. § 1129(b)(2)(A)(ii) (providing that secured claims receive fair and equitable treatment when the plan provides “for the sale . . . of any property that is subject to the liens securing such claims, free and clear of such liens, *with such liens to attach to the proceeds of such sale*” (emphasis added)).

<sup>337</sup> See *Fogel v. Zell*, 221 F.3d 955, 965 (7th Cir. 2000) (“And thus when an asset of the estate is sold by the trustee in bankruptcy free and clear of any liens, the court can enjoin a creditor from suing to enforce a preexisting lien in the asset.”); *In re Dow Corning Corp.*, 198 B.R. 214, 245 (Bankr. E.D. Mich. 1996) (explaining that bankruptcy courts may use § 105(a) to issue an injunction barring a creditor from seeking to enforce an interest in property purchased from the debtor under § 363(f) where the injunction is “necessary and appropriate to give the ‘free and clear’ aspect of § 363(f) meaning”) (collecting authorities); *P.K.R. Convalescent Ctrs., Inc. v. Va. (In re P.K.R. Convalescent Ctrs., Inc.)*, 189 B.R. 90, 96 (Bankr. E.D. Va. 1995) (“Accordingly, § 105[(a)] authorizes this court to enjoin any act to collect an interest in the bankruptcy estate in contravention of a court order to sell the property free and clear of *all interests* under § 363(f)(5).”).

<sup>338</sup> 11 U.S.C. § 103(a) (2006) (“Except as provided in section 1161 of this title, chapters 1, 3 and 5 of this title apply in cases under chapter 7, 11, 12, or 13 of this title . . .”).

<sup>339</sup> *Cf. Homsy v. Floyd (In re Vitek, Inc.)*, 51 F.3d 530, 531-32 (5th Cir. 1995) (in a Chapter 7 liquidation, after the debtor settled with its liability insurance carriers and the bankruptcy court approved the settlement, the bankruptcy court issued an injunction barring all third parties

eliminate the need to pay dissenting creditors in full on the claims extinguished by an insurance third-party release. To elaborate, remember that the payment-in-full requirement applies to *general* third-party releases because of the best interests test. Since that type of release is *prohibited* in Chapter 7 cases, if the debtor were to liquidate, the creditor would receive complete satisfaction on its claim from the debtor, the co-obligor, or a combination of the two. The best interests test mandates that the creditor receive as much in the debtor's Chapter 11 case as it would receive in a Chapter 7. Accordingly, a Chapter 11 plan must promise the creditor full payment on any claims extinguished by a *general* third-party release. However, if *insurance* non-debtor releases are *permissible* in Chapter 7, the crucial first premise of this argument is not true with respect to insurance releases.<sup>341</sup> Hence, insurance third-party releases would be exempt from the payment-in-full element contained in both versions of the *Master Mortgage* test.

Similar arguments exist that the remaining elements of the two *Master Mortgage* tests are either moot or inapplicable to insurance releases,<sup>342</sup> if such releases are in fact authorized under § 363(f).<sup>343</sup> But these arguments are not

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(including additional insureds and tort claimants) from suing the insurers for claims seeking additional coverage under the settled policies; however, as part of their settlements with the debtor, the insurers paid the *full* policy limits into the estate, distinguishing this case from the primary factual scenario involving insurance non-debtor releases; moreover, the Fifth Circuit did not mention § 363(f) or otherwise identify the statutory basis for the sale and injunction).

<sup>340</sup> See *supra* notes 215, 220 and accompanying text.

<sup>341</sup> In addition to § 363(f), two provisions of Chapter 11—§§ 1123(a)(5)(D) and 1129(b)(2)(A)(ii)—might also authorize insurance non-debtor releases. If insurance releases are permissible only under one or both of the Chapter 11 sections, and *not* under § 363(f), then the analysis offered in the body changes. Unlike § 363(f), the two Chapter 11 statutes do *not* apply in Chapter 7 bankruptcies. 11 U.S.C. § 103(g). *Insurance* third-party releases would thus be *prohibited* in Chapter 7 cases, just like *general* non-debtor releases. And therefore, the argument that the best interests test mandates payment in full on claims extinguished by *general* releases would have equal force when applied to *insurance* releases.

<sup>342</sup> For example, both tests require an “identity-of-interest” between the released third party and the debtor. This element concerns subject matter jurisdiction. Such jurisdiction will always exist in the context of a § 363(f) sale and a supporting injunction because bankruptcy courts have jurisdiction over all property of the estate. 28 U.S.C. § 1334(e)(1) (2006). Both versions of the *Master Mortgage* test also mandate that a non-debtor release be “essential to the reorganization.” See *supra* notes 203, 211 and accompanying text. But the standard for approving a sale under § 363 is “essentially a business judgment test,” 3 COLLIER ON BANKRUPTCY ¶ 363.02[1][f] (15th ed. rev. 2005), a much lower standard. Finally, both versions of the *Master Mortgage* test require a substantial level of creditor consent to any third-party release. However, there is no similar requirement that a trustee obtain consent from creditors before conducting a § 363 sale. See, e.g., 11 U.S.C. § 363(b), (c), (f). Creditors may object, 3 COLLIER ON BANKRUPTCY ¶ 363.02[1][2], but their dissent *alone* cannot block a sale under § 363.

<sup>343</sup> The authorities adopting the first position—that only *the debtor's* interest in liability insurance proceeds is part of the estate—have expressly rejected § 363(f) as a basis for granting insurance non-debtor releases; and they have done so precisely on the ground that only the debtor's interest in the proceeds is estate property. For example, in *In re Adelpia Communications Corp.*, 364 B.R. 518 (Bankr. S.D.N.Y. 2007), the court concluded that § 363(f) was inapplicable because it found that the proceeds rights of the director and officer additional insureds were not derived from any

interest in property of the estate, but rather flowed from “contractual entitlement[s]” against the carriers that were *independent* of the estate. *Id.* at 527; *accord In re Forty-Eight Insulations, Inc.*, 133 B.R. 973, 978 (Bankr. N.D. Ill. 1991) (holding that a debtor may not use § 363(f) to sell a liability insurance policy back to the insurer free of the interests of a co-insured because the co-insured’s interest in the policy does “not become property of the estate”), *aff’d*, 149 B.R. 860, 864 (N.D. Ill. 1992) (“The [bankruptcy] court correctly held that another party’s interests do not become property of the estate and therefore cannot be sold under § 363 which deals with the sale of property of the estate.”).

There are also arguments that § 363(f) does not permit insurance non-debtor releases even if the second position is correct—even if *all* liability insurance proceeds are indeed estate property. The power to authorize a sale of property free and clear of third-party interests under § 363(f) is contingent upon meeting one of five conditions. *See* 11 U.S.C. § 363(f)(1)-(5) (2006). Only two of these conditions could possibly be satisfied in the context of an insurance settlement for less than the policy proceeds that contains a non-debtor release of the carrier. *First*, § 363(f)(4) permits a free-and-clear sale where the third-party’s property “interest is in bona fide dispute.” *Id.* § 363(f)(4). This provision might be satisfied with respect to tort plaintiffs if their claims against the debtor are legitimately contested. *See In re Dow Corning Corp.*, 198 B.R. 214, 245 (E.D. Mich. 1996) (holding that the tort claimants’ interest, if any, in the debtor’s insurance policies were subject to bona fide dispute, satisfying § 363(f)(4), because “the Debtor vehemently denies liability to the tort claimants”). The standard might also be met against tort claimants *and* additional insureds if the carrier has legitimate bases for challenging the debtor’s or the additional insured’s entitlement to coverage. But if there is no valid argument available to place the interests of tort plaintiffs or additional insureds in bona fide dispute, then § 363(f)(4) is inapplicable. *Second*, § 363(f)(5) allows for a sale free and clear where the third party “could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.” 11 U.S.C. § 363(f)(5). Since tort claimants merely possess a right to payment out of insurance proceeds, it seems likely that § 363(f)(5) could be used to transfer insurance policies free of their property interests. Additional insureds, however, beyond their right to the payment of proceeds, are typically owed a duty to defend by the carrier. This *might* mean that § 363(f)(5) may only be used to extinguish the claims of tort plaintiffs against the carrier. On this reading, the claims of additional insureds are beyond the scope of the statute.

The power to sell property free and clear in a Chapter 11 plan is not limited to the five conditions in § 363(f). 7 COLLIER ON BANKRUPTCY ¶ 1129.05[2][b][iv] (15th ed. rev. 2004). Thus, including an insurance non-debtor release in the debtor’s plan of reorganization may avoid the limitations set forth in that statute. However, the two provisions of Chapter 11 that provide the power to sell estate property free and clear use the more specific term “lien” in describing such sales. *See* 11 U.S.C. § 1123(a)(5)(D) (permitting “sale of all or any part of the property of the estate, either subject to or free of any *lien*” (emphasis added)); *id.* § 1129(b)(2)(A)(ii) (providing for sales “free and clear of such *liens*” (emphasis added)). Now, another Chapter 11 provision, § 1141(c), provides that “the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.” *Id.* § 1141(c) (emphasis added). But, while § 1141(c) uses the broader term “interest,” the “free and clear” impact of that statute is limited by the terms of the plan of reorganization: Property dealt with by the plan is free and clear “except as otherwise provided in the plan.” *Id.* Thus, if there is no statute in Chapter 11 that permits a plan to include a sale free and clear of interests that are *not liens*, the plan would either (1) have to preserve the property interests of tort claimants and additional insureds, mooted any “free and clear” impact of § 1141(c), or (2) satisfy the requirements of § 363(f). In sum, a sale free and clear of the type of “interests” in the debtor’s insurance held by tort claimants and additional insureds might go beyond the power granted by the specific language of §§ 1123(a)(5)(D) and 1129(b)(2)(A)(ii). That would leave § 363(f) as the only statutory basis for

sufficiently pertinent to the issues raised by *asbestos* non-debtor releases to warrant significant attention here.

To recap: If only the *debtor's* interest in liability insurance proceeds is property of the estate, then the standard rules applicable to non-debtor releases also govern insurance releases. The sole statutory bases for insurance third-party releases would be §§ 105(a) and 1123(b)(6), the provisions granting bankruptcy courts their general equitable powers. And many courts have ruled that these laws do not provide sufficient authority for non-debtor releases. If *all* of the liability insurance proceeds are estate property, however, then bankruptcy courts have other statutes at their disposal—§§ 363(f), 1123(a)(5)(D) and 1129(b)(2)(A)(ii). Extinguishing the claims of co-insureds and tort plaintiffs against an insurer is arguably more justifiable under these statutes than under the two equitable provisions.<sup>344</sup> Moreover, the limits that pro-release authorities impose on *general* non-debtor releases are largely inapplicable to *insurance* releases, to the extent the latter may be granted under § 363(f). And thus, *insurance* non-debtor releases would be distinguishable from *general* releases in critical ways.<sup>345</sup>

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such relief. Of course, there is an argument that the tort claimants' interests *are* essentially the equivalent of liens, *see supra* notes 290-91, 297, and accompanying text, but it is virtually impossible to reach the same conclusion with respect to the interests of additional insureds.

Two final points relating to the scope of § 363(f) deserve brief attention. *First*, suppose that a co-insured is not merely an additional insured, but rather jointly purchases the insurance with the debtor and is also a primary, named insured. In that situation, the debtor and the co-insured would best be conceptualized as co-owners of the policy. Any attempt to extinguish the co-insured's rights in such a case via an insurance non-debtor release would probably be governed by § 363(h), rather than § 363(f). Section 363(h) permits the sale of property free and clear of the rights of certain joint owners if a series of stringent requirements is met. *See* 11 U.S.C. § 363(h)(1)-(4); 3 COLLIER ON BANKRUPTCY ¶ 363.08[1] (15th ed. rev. 2005) ("Because [§ 363(h)] authorizes a trustee to sell and thereby deprive a nondebtor of its property, there are significant conditions to the exercise of the power."). It might be very difficult to show that an insurance non-debtor release satisfies § 363(h). (Since *additional* insureds are third-party beneficiaries under an insurance policy, not co-owners, *In re Adelpia Commc'ns Corp.*, 364 B.R. at 525, § 363(h) is *not* relevant where the non-debtor insured is merely an additional insured.) *Second*, suppose that the *debtor* was the additional insured on a policy procured by a parent or other related company. In that case, I suspect that neither § 363(f) *nor* § 363(h) would be available. *See In re Forty-Eight Insulations, Inc.*, 133 B.R. at 978 n.5 (stating that § 363(h) had "no application" in a case mirroring these facts).

<sup>344</sup> *See* Zaretsky, *supra* note 141, at 410-11 ("Of course, any determination based on the court's 'channeling' power is dependent on a finding that the policy proceeds are property of the estate. If the insurance proceeds were viewed as an asset that does not become property of the estate, they would not be subject to the 'channeling' power and section 363(f) would not apply."); *see also In re Elsinore Shore Assoc.*, 91 B.R. 238, 253-54 (Bankr. D.N.J. 1988) (distinguishing *Johns-Manville* because the claims at issue there were against property of the estate—i.e., the insurance policies, whereas Elsinore Shore Associates requested the enjoining of claims against independent third parties).

<sup>345</sup> There are plausible middle grounds between these two extremes. For example, perhaps an additional insured's right to policy proceeds is *not* an interest in estate property, but a tort claimant's right to such proceeds *does* constitute such an interest. Under this legal conclusion, the standard non-debtor release rules would apply to the release of claims held by additional insureds,

## V. SECTION 524(g) OF THE BANKRUPTCY CODE

### A. The Purpose and General Structure of Section 524(g)

As Part IV illustrates, the law with respect to non-debtor releases is unsettled. In the aftermath of the *Manville* case, Congress believed that similar uncertainty plagued the usage of a litigation trust and channeling injunction to address future claims, and that the ambiguous legal environment inhibited *Manville*'s attempts to raise money for its on-going operations.<sup>346</sup> This “undermined the ‘fresh start’ objectives of bankruptcy and the goals of the trust arrangement.”<sup>347</sup> Section 524(g),<sup>348</sup> and its companion provision § 524(h),<sup>349</sup> were intended to remove the cloud hanging over the “trust/injunction mechanism” used in *Manville*, and subsequently in the bankruptcy of UNR,<sup>350</sup> and legitimize those procedures for other companies seeking to reorganize because of asbestos liabilities.<sup>351</sup>

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while §§ 363(f), 1123(a)(5)(D) and 1129(b)(2)(A)(ii) would potentially govern the release of claims against the carrier held by tort claimants.

<sup>346</sup> See H.R. REP. NO. 103-835, at 40 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3349 (“Nevertheless, lingering uncertainty in the financial community as to whether the injunction can withstand all challenges has apparently made it more difficult for [*Manville*] to meet its needs for capital and has depressed the value of its stock.”).

<sup>347</sup> *Id.*; see also 140 CONG. REC. S4523 (daily ed. Apr. 20, 1994) (remarks of Sen. Brown) (“Without a clear statement in the code of a court’s authority to issue such injunctions, the financial markets tend to discount the securities of the reorganized debtor. This in turn diminishes the trust’s assets and its resources to pay victims.”).

<sup>348</sup> 11 U.S.C. § 524(g) (2006).

<sup>349</sup> *Id.* § 524(h).

<sup>350</sup> See *Unarco Bloomington Factory Workers v. UNR Indus., Inc.*, 124 B.R. 268, 271-72 (Bankr. N.D. Ill. 1990) (summarizing a Chapter 11 plan that substantially mirrored *Manville*’s in its treatment of asbestos tort claims); H.R. REP. NO. 103-835, at 40, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3349 (explaining that UNR “has resolved its chapter 11 reorganization with a similar trust/injunction arrangement”).

<sup>351</sup> H.R. REP. NO. 103-835, at 41, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3349 (“The Committee has approved section 111 of the bill in order to strengthen the *Manville* and UNR trust/injunction mechanisms and to offer similar certitude to other asbestos/trust injunction mechanisms that meet the same kind of high standards with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases.”).

As indicated in the main text, Congress wished to legitimize the trust/injunction structure in both future actions *and* in asbestos bankruptcies that utilized the structure prior to the enactment of § 524(g)—namely the *Manville* and *UNR* cases. The *retroactive* effect was accomplished through § 524(h), which essentially created a *post hoc* statutory basis for the previously issued *Manville* and UNR channeling injunctions. Subsection (h) provides that injunctions issued in asbestos bankruptcies before the enactment of § 524(g), and having substantially the same impact as a § 524(g) injunction, shall be deemed to satisfy virtually all of the requirements of subsection (g), if three additional standards are met. 11 U.S.C. § 524(h)(1). First, when the plan was initially confirmed, the court determined that the plan was “fair and equitable in accordance with the requirements of section 1129(b).” *Id.* § 524(h)(1)(A). Second, the court appointed a future claims representative as part of the confirmation process. *Id.* § 524(h)(1)(B). And third, the future claims representative “did not object to confirmation of the plan or issuance of” the injunction. *Id.* §

In designing § 524(g), Congress had the same aim as the drafters of the reorganization plan in *Johns-Manville*—finding a way to “preserve the going concern value” of the debtor in order to provide “a source of payment for . . . future claims.”<sup>352</sup> Congress was also impressed by the protections afforded present and future claimants in the Manville and UNR bankruptcies.<sup>353</sup> It felt that such protections were a required feature of any trust/injunction mechanism enacted into law.<sup>354</sup> As a result, Congress modeled the statute on the specific structure established in the Manville case.<sup>355</sup>

When crafting § 524(g), Congress was primarily focused on the features of the litigation trust and the rights of future claimants.<sup>356</sup> Extending injunctive protection to third parties received comparatively little attention. It was noted in passing during the Senate debate,<sup>357</sup> but was not mentioned once in the House debate<sup>358</sup> or in the House Report on the statute.<sup>359</sup> Nonetheless, provisions allowing the bankruptcy court to shield non-debtors via the trust/injunction mechanism were included in the statute.<sup>360</sup>

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524(h)(1)(C); *see also id.* § 524(h)(2) (containing some additional provisions regarding how § 524(g) applies to pre-enactment litigation trusts that, as of the effective date of the statute, were under a stay of operations).

<sup>352</sup> 140 CONG. REC. S4523 (daily ed. Apr. 20, 1994) (remarks of Sen. Graham); *see also* Part III.B.2. (discussing the purposes of the Manville trust and injunction).

<sup>353</sup> 140 CONG. REC. S4523 (remarks of Sen. Graham).

<sup>354</sup> *See* H.R. REP. No. 103-835, at 41, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3349 (“The Committee has concluded, therefore, that creating greater certitude regarding the validity of the trust/injunction mechanism must be accompanied by explicit requirements simulating those met in the Manville case.”).

<sup>355</sup> *Id.* at 40, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3348.

<sup>356</sup> On the protection of future claimants, *see id.* (describing § 524(g) as involving “the establishment of a trust to pay the future claims, coupled with an injunction to prevent future claimants from suing the debtor”); *id.* at 40, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3349 (“The Committee remains concerned that full consideration be accorded to the interests of future claimants who, by definition, do not have their own voice.”); 140 CONG. REC. S4523 (remarks of Sen. Graham) (“It is the uncertainty of the number and amount of these future claims, and the need to implement a procedure that recognizes these future claimants as creditors under the U.S. Bankruptcy Code, that necessitates this amendment . . .”); *see also* Brown, *supra* note 32, at 902 n.164 (noting that the legislative history “clearly establishes the focus of Section 524(g) is to protect future claimants”); Plevin et al., *Future Claims Representative*, *supra* note 32, at 271-72 (“The central innovation of § 524(g) is that it provides a means by which a debtor can limit the rights of persons—the future claimants—who are not present in court to defend those rights.”); Alan N. Resnick, *Bankruptcy As a Vehicle for Resolving Enterprise Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2073 (2000) (stating that the purpose of the “asbestos amendments” was to protect debtor manufacturers from future liability).

<sup>357</sup> *See* 140 CONG. REC. S4523-24 (daily ed. Apr. 20, 1994) (remarks of Sens. Graham, Helfin, Cambell & Brown).

<sup>358</sup> *See* 140 CONG. REC. H10765-66 (daily ed. Oct. 4, 1994) (remarks of Rep. Brooks); *id.* at H10772 (remarks of Rep. Fish).

<sup>359</sup> *See* H.R. REP. No. 103-835, at 40-41, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3348-50.

<sup>360</sup> 11 U.S.C. § 524(g)(4) (2006).

Section 524(g) allows bankruptcy courts to issue an injunction that “supplement[s] the injunctive effect of a discharge”<sup>361</sup> by shielding the debtor and certain third parties from current and future asbestos-related claims.<sup>362</sup> The injunction may enjoin entities from taking legal action to recover “on any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by” a qualifying litigation trust<sup>363</sup> established to address the debtor’s asbestos liabilities.<sup>364</sup> This relief, which is referred to as a “supplemental injunction” or a “channeling injunction,” is designed to immunize the reorganized debtor from litigation so that it can generate the funds necessary to satisfy its tort obligations,<sup>365</sup> and provide an incentive for related non-debtors to contribute assets to the litigation trust for the payment of tort claims.<sup>366</sup>

### **B. The Requirements for a Supplemental Injunction Protecting the Debtor**

Section 524(g) contains an exacting series of requirements that must be satisfied before the court may issue a supplemental injunction protecting the debtor. And the statute adds further conditions on top of the general requirements if the injunction also shields non-debtors. This subpart sets forth the general requirements, those that must be met before *any* § 524(g) injunction is permissible.

First, and most importantly, the injunction must be issued “in connection with” an order “confirming a plan of reorganization under chapter 11.”<sup>367</sup> This entails that the debtor be reorganizing pursuant to Chapter 11, not liquidating under Chapter 7.<sup>368</sup> Thus, in addition to the requirements specified by § 524(g), the supplemental injunction and the related provisions of the debtor’s plan of reorganization have to comply with Chapter 11’s mandates.<sup>369</sup>

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<sup>361</sup> *Id.* § 524(g)(1)(A).

<sup>362</sup> *Id.* § 524(g)(3)-(5).

<sup>363</sup> *Id.* § 524(g)(1)(B). A “demand” is essentially a future claim that was not asserted during the bankruptcy. *See id.* § 524(g)(5).

<sup>364</sup> *See id.* § 524(g)(2)(B)(i), (i)(I).

<sup>365</sup> 140 CONG. REC. S4523 (daily ed. Apr. 20, 1994) (remarks of Sen. Brown) (“The underlying company funds the trust with securities and the company remains viable. Thus, the company continues to generate assets to pay claims today and into the future.”).

<sup>366</sup> *Id.* (remarks of Sen. Graham) (“By providing a trust to pay claims and an injunction channeling the present and future asbestos claims to that trust, the debtor *and third parties* who are alleged to be liable for the asbestos claims against the debtor will be encouraged to participate in a system that will maximize the assets available to asbestos claims, present and future, and provide for an equitable distribution and method of payment.” (emphasis added)); Porter, *supra* note 30, at 229 (“The inclusive protection of parents, affiliates, and subsidiaries that is contemplated by § 524(g) rests on the premise that these parties will make appropriate contributions to the trust in order to justify the benefit of the channeling injunction.”); *see also id.* at 229 (contending that the statute has succeeded in inducing third parties to make contributions in exchange for injunctive relief).

<sup>367</sup> 11 U.S.C. § 524(g)(1)(A).

<sup>368</sup> NAT’L BANKR. REVIEW COMM’N, *BANKRUPTCY: THE NEXT TWENTY YEARS* 321 (1997).

<sup>369</sup> *In re Combustion Eng’g, Inc.* 391 F.3d 190, 234 (3d Cir. 2004) (“To achieve this [supplemental injunctive] relief, a debtor must satisfy the prerequisites set forth in § 524(g), in addition to the

Second, the debtor must be “subject to substantial future demands for payment” arising from its asbestos-related activities.<sup>370</sup> Third, the “amounts, numbers, and timing of such future demands” need to be impossible to determine.<sup>371</sup> Fourth, if future claimants pursue these demands “outside the procedures prescribed by” the reorganization plan, such action is “likely to threaten the plan’s purpose to deal equitably with claims and future demands.”<sup>372</sup> For example, in the bankruptcy of The Babcock & Wilcox Company, the court found this requirement to be met because, without the plan mechanisms, “claims would be paid on a first come first serve basis . . . leaving little or nothing to pay later filed claims.”<sup>373</sup>

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standard plan confirmation requirements.” (citing 11 U.S.C. § 524(g)(1)(A)); *see, e.g., In re Porter Hayden Co.*, No. 02-54152-SD, 2006 WL 4667137, at \*1-\*4 (Bankr. D. Md. Jun. 30, 2006) (separately addressing the requirements of Chapter 11 generally and of § 524(g) specifically), *aff’d*, No. 06-201, 2006 WL 4672671 (Bankr. D. Md. Jul. 7, 2006); *In re Kaiser Aluminum Corp.*, No. 02-10429(JKF), 7312, 2006 WL 616243, at \*5-\*17 (Bankr. D. Del. Feb. 6, 2006) (same), *aff’d*, 343 B.R. 88 (D. Del. 2006); *In re J T Thorpe Co.*, 308 B.R. 782, 784-93 (Bankr. S.D. Tex. 2003), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003) (same), *aff’d*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004).

<sup>370</sup> Section 524(g)(2)(B)(ii)(I) states that “the debtor is likely to be subject to substantial future demands for payment arising out of the same or similar conduct or events that gave rise to the claims *that are addressed by the injunction.*” 11 U.S.C. § 524(g)(2)(B)(ii)(I) (emphasis added). And § 524(g)(2)(B)(i)(I) makes it clear that the “claims that are addressed by the injunction” must be the debtor’s asbestos-related liabilities. *See id.* § 524(g)(2)(B)(i)(I) (stating that a § 524(g) litigation trust, which is prerequisite to a supplemental injunction, may only assume the liabilities of a debtor who “has been named as a defendant in personal injury, wrongful death, or property damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products.”); *see also In re Combustion Eng’g, Inc.*, 391 F.3d at 234 n.45 (explaining that the debtor must be subject to “substantial demands for payment in the future arising out of” its asbestos-related activities). For good examples of cases where the debtor satisfied the requirement of § 524(g)(2)(B)(i)(I), *see In re Celotex Corp.*, 204 B.R. 586, 604 (Bankr. M.D. Fla. 1996) (primary debtor faced nearly 100,000 personal injury asbestos claims upon filing for bankruptcy in 1990 and 737,033 by the claim-filing deadline), and *In re Federal-Mogul Global Inc.*, No. 01-10578, 2007 WL 4180545, at \*29 (Bankr. D. Del. Nov. 16 2007) (debtor projected to face 200,000 to 500,000 claims over the next 40 years).

<sup>371</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(II); *see also Sander L. Esserman & David J. Parsons, The Case for Broad Access to 11 U.S.C. § 524(g) in Light of the Third Circuit’s Ongoing Business Requirement Dicta in Combustion Engineering*, 62 N.Y.U. ANN. SURV. AM. L. 187, 193 n.30 (2006) (contending this is an “easy” requirement to satisfy because, “[g]iven the history of asbestos litigation, the lengthy latency periods . . . , and evolving medical technology, it is difficult to predict with even a modicum of certainty the timing or extent of future demands that may be asserted against the Debtor”).

<sup>372</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(III).

<sup>373</sup> *In re The Babcock & Wilcox Co.*, No. 00-10992, 2004 WL 4945985, at \*22 (Bankr. E.D. La. Nov. 9, 2004), *vacated on other grounds*, No. Civ.A. 05-232, 2005 WL 4982364 (E.D. La. Dec. 28, 2005); *see also* 4 COLLIER ON BANKRUPTCY ¶ 524.07[2], at 524-50 (15th ed. rev. 2008) (“[I]f the court finds that the viability of the debtor or a successor, after reorganization, would not be seriously threatened by the assertion” of present and future claims, then § 524(g)(2)(B)(ii)III is not satisfied.).

Fifth, as noted above, the supplemental injunction must be “implemented in connection with” a litigation trust, established by the debtor’s plan of reorganization.<sup>374</sup> Sixth, the trust has to assume the asbestos liabilities of the debtor<sup>375</sup> and use “its assets or income to pay claims and demands.”<sup>376</sup> Seventh, the trust must be funded “in whole or in part” by the debtor’s securities and by an obligation of the debtor “to make future payments, including dividends,” to the trust.<sup>377</sup> Eighth, the trust must either own, “or by the exercise of rights granted under such plan . . . be entitled to own if specified contingencies occur, a majority of the voting shares of” the debtor, the debtor’s parent corporation, or each subsidiary of the debtor that is also a debtor in the bankruptcy.<sup>378</sup> This requirement ensures that the trust may obtain control of the reorganized debtor if the trust otherwise turns out to have insufficient funds to fulfill its obligations under the plan of reorganization.<sup>379</sup> Ninth, the trust’s operating procedures must “provide reasonable assurance” that the trust will have the financial resources to pay in “substantially the same manner” comparable present claims and future demands.<sup>380</sup> Significant discrimination between present claims and future

<sup>374</sup> 11 U.S.C. § 524(g)(2)(B)(i).

<sup>375</sup> *Id.* § 524(g)(2)(B)(i)(I); Findley v. Falise (*In re* Joint E. & S. Dist. Asbestos Litig.), 878 F. Supp. 473, 571 (S.D.N.Y. 1995) (explaining that the trust “must . . . assume the debtor’s wrongful death, personal injury and property damage liabilities for exposure to asbestos products”), *aff’d in part, vacated in part*, 78 F.3d 764 (2d Cir. 1996). Some courts have held that the trust may assume non-asbestos liabilities as well. See *In re* Eagle-Picher Indus., Inc., 203 B.R. 256, 267 (Bankr. S.D. Ohio 1996) (holding that debtor’s § 524(g) trust could assume debtor’s lead liabilities as well as its asbestos liabilities).

<sup>376</sup> 11 U.S.C. § 524(g)(2)(B)(i)(IV).

<sup>377</sup> *Id.* § 524(g)(2)(B)(i)(II); see, e.g., *In re* Celotex Corp., 204 B.R. 586, 602-04 (Bankr. M.D. Fla. 1996) (outlining the funding of the trust—which included (1) hundreds of millions in common stock of the reorganized debtor, and (2) promissory notes valued at \$200 million issued by the reorganized debtor to the trust—and noting that the total funding exceeded \$1.2 billion). Some courts have interpreted this provision to require that the reorganized debtor constitute a “going concern”—that it have some continuing business operations after exiting bankruptcy. See, e.g., *In re* Combustion Eng’g, Inc., 391 F.3d 190, 238 (3d Cir. 2004) (“The implication of this requirement is that the reorganized debtor must be a going concern, such that it is able to make future payments into the trust to provide an ‘evergreen’ funding source for future asbestos claimants.”). *Contra* Esserman & Parsons, *supra* note 371, at 187 (“This paper argues that there has not been and should not be an ongoing business requirement. . .”).

<sup>378</sup> 11 U.S.C. § 524(g)(2)(B)(i)(III).

<sup>379</sup> 4 COLLIER ON BANKRUPTCY ¶ 524.07[2], at 524-50 (15th ed. rev. 2008). The “contingency” that grants a trust control of the debtor must be an event that would occur prior to the point in time when obtaining control of the debtor would be worthless. *In re* Congoleum Corp., 362 B.R. 167, 175-79 (Bankr. D.N.J. 2007) (holding that debtor’s plan did not satisfy § 524(g)(2)(B)(i)(III) because there was “no plausible scenario” in which the trust would be able to obtain a controlling interest in debtor’s stock “when [the shares] were still valuable”).

<sup>380</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(V) (2006). The statute explains that the trust “will operate through mechanisms such as structured, periodic, or supplemental payments, pro rata distributions, matrices, or periodic review of estimates of the numbers and values of present claims and future demands, or other comparable mechanisms.” *Id.*

demands, or between substantively similar present claims, is prohibited by this requirement.<sup>381</sup>

Tenth, as part of the confirmation process, the persons with claims to be addressed by the trust must be placed in a separate class (or classes).<sup>382</sup> Eleventh, at least seventy-five percent of the members of the separate class voting on the plan have to vote in the plan's favor.<sup>383</sup> Twelfth, the court must appoint a legal representative for future claimants "for the purpose of protecting" their rights.<sup>384</sup> Nothing in the statute states that the representative must approve of the plan as a prerequisite to confirmation,<sup>385</sup> but "future claimants' representatives have asserted that no channeling injunction may be issued without their endorsement."<sup>386</sup> Thirteenth, the court must determine that granting the protections of a supplemental injunction to the debtor is "fair and equitable" to future claimants "in light of the benefits provided" to the trust "on behalf of such debtor."<sup>387</sup>

Fourteenth, the terms of the supplemental injunction need to be set forth in both the plan of reorganization and the disclosure statement.<sup>388</sup> Fifteenth, after adequate notice, the court must conduct a hearing on the injunction.<sup>389</sup> Sixteenth, the supplemental injunction does not become effective until "the order confirming the plan of reorganization" is "issued or affirmed by the *district court*" and the time for appeal from the district court's action has expired.<sup>390</sup>

<sup>381</sup> See *In re Congoleum Corp.*, 362 B.R. at 183-84 (holding that the plan violated § 524(g)(2)(B)(ii)(V) because the plan classified and treated differently asbestos claims based solely upon the time at which the claims were filed); *In re ACandS, Inc.*, 311 B.R. 36, 42 (Bankr. D. Del. 2004) (finding that plan violated § 524(g)(2)(B)(ii)(V) because of excessive discrimination between claims).

<sup>382</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb). The statute's reference to multiple "classes" is relevant in several contexts. First, when a bankruptcy involves multiple debtors, each with their own asbestos claimants, it may be appropriate to place the plaintiffs for each debtor in a distinct class. Second, most courts put personal injury claimants and property damage claimants in separate classes. See, e.g., *In re Celotex Corp.*, 204 B.R. at 605 (finding § 524(g)(2)(B)(ii)(IV)(bb) satisfied where the primary debtor's asbestos personal injury claimants and asbestos property damage claimants were placed in two separate classes (Classes six and eight respectively)). For a third context, see *infra* note 456.

<sup>383</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb).

<sup>384</sup> *Id.* § 524(g)(4)(B)(i). See generally *Fed. Ins. Co. v. W.R. Grace, Civ. Ac. No. 04-844*, 2004 WL 55 5517843, \*4-\*10 (D. Del. Nov. 22, 2004) (addressing various issues regarding the appointment of a § 524(g) future claims representative, including the proper statutory authority for the appointment, the correct conflict-of-interest standard, and the appropriate appointment procedure).

<sup>385</sup> See *Barliant, supra* note 32, at 457 n.84 ("The Bankruptcy Code does not require that the future claims' representative approve the section 524(g) trust or the overall plan.").

<sup>386</sup> *Plevin et al., Pre-Packaged Asbestos Bankruptcies, supra* note 32, at 909 n.121.

<sup>387</sup> 11 U.S.C. § 524(g)(4)(B)(ii).

<sup>388</sup> *Id.* § 524(g)(2)(B)(ii)(IV)(aa).

<sup>389</sup> *Id.* § 524(g)(1)(A).

<sup>390</sup> *Id.* § 524(g)(3)(A)-(A)(i) (emphasis added). The statute further provides that, once the injunction becomes "valid and enforceable," it "may not be revoked or modified by any court except through appeal in accordance with paragraph (6)." *Id.* at 524(g)(3)(A)(i) (emphasis added);

These sixteen requirements are all expressly set forth in the statute. But some authorities have interpreted various portions of § 524(g) to imply additional mandates. For example, the statute provides that a channeling injunction may be entered to “supplement the injunctive effect of a discharge.”<sup>391</sup> In construing this language, one court ruled that, since the injunction is supposed to “supplement” the “discharge,” at least one debtor in the bankruptcy must be entitled to a discharge under § 1141(d);<sup>392</sup> otherwise, a supplemental injunction is impermissible.<sup>393</sup>

### C. Section 524(g)'s Additional Requirements When The Injunction Protects Non-Debtors

Section 524(g)(4) allows some non-debtors to receive the protection of the supplemental injunction—i.e., it permits the issuance of non-debtor releases.<sup>394</sup>

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*see also id.* § 524(g)(6) (preserving the power of an “appellate court” to act on an appeal either of an injunction issued under the statute or of “the order of confirmation that relates to the injunction.”). However, the statute also states that “after entry of such injunction, any proceeding that involves the validity, application, construction, or *modification* of such injunction . . . may be commenced only in the district court in which such injunction was entered.” *Id.* § 524(g)(2)(A) (emphasis added). While paragraphs (3)(A)(i) and (2)(A) appear to be in conflict, they can be reconciled as follows: Subparagraph (3)(A)(i) bars attempts to change the terms of the injunction, whereas subparagraph (2)(A) addresses modifications expressly contemplated by the initial terms of the confirmation order.

<sup>391</sup> *Id.* § 524(g)(1)(A).

<sup>392</sup> *Id.* § 1141(d).

<sup>393</sup> *See In re W. Asbestos Co.*, 313 B.R. 832, 854 (Bankr. N.D. Cal. 2003); *see also* Esserman & Parsons, *supra* note 371, at 200-01, 204 (summarizing and rejecting this argument). For another example, *see also supra* note 377 (discussing the implied “going-concern” requirement).

<sup>394</sup> Extending the supplemental injunction to non-debtors under § 524(g)(4) should be distinguished from the legal impact of another part of the statute. Under § 524(g)(3), some third parties are *automatically* entitled to a measure of protection, *apart from the supplemental injunction*, when the requirements regarding the litigation trust are satisfied. *See* 11 U.S.C. § 524(g)(3)(A). That paragraph provides that entities who become direct or indirect transferees of the debtor or the trust, pursuant to the reorganization plan or afterwards, shall not be liable on any asbestos-related claims by reason of the transfer. *Id.* § 524(g)(3)(A)(ii) (providing that “no entity that pursuant to such plan or thereafter becomes a direct or indirect transferee of, or successor to any assets of, a debtor or trust that is the subject of the injunction shall be liable with respect to any claim or demand made against such entity by reason of its becoming such a transferee or successor”). This provision is designed to cut off any successor liability such transferees might otherwise face. 4 COLLIER ON BANKRUPTCY ¶ 524.07[4] (15th ed. rev. 2008). Similarly, persons that loan money to the debtor, the trust, or a transferee of either, pursuant to the reorganization plan or afterwards, are not liable to any asbestos claimants simply in virtue of the loan. 11 U.S.C. § 524(g)(3)(A)(iii) (stating that “no entity that pursuant to such plan or thereafter makes a loan to such a debtor or trust or to such a successor or transferee shall, by reason of making the loan, be liable with respect to any claim or demand made against such entity, nor shall any pledge of assets made in connection with such a loan be upset or impaired for that reason”); *see also id.* § 524(g)(3)(B)(ii) (providing that the protection for transferees and lenders does not shield them from liability under fraudulent transfer law). Extinguishing a third party’s successor liability, arising because of its transactions with the debtor taking place *after* the bankruptcy filing, involves a different set of issues from releasing or

However, the statute lists additional conditions that must be met when the injunction shields third parties. First, any non-debtor who will be receiving the benefits of the injunction must be identified “by name or as part of an identifiable group” in the terms of the injunction.<sup>395</sup> Second, as with the debtor, protecting a third party via the injunction must be fair and equitable to future claimants “in light of the benefits provided” to the trust “on behalf of such . . . third party.”<sup>396</sup> Notably, this language does not mandate that every third party contribute funds to the trust; it merely requires that someone provide funding on the non-debtor’s “behalf.”<sup>397</sup>

Third, § 524(g) only permits certain third parties to receive the protection of the injunction—and they may be shielded from only particular types of asbestos claims.<sup>398</sup> Section 524(g)(4)(A)(ii) provides that the supplemental injunction may bar actions against non-debtors “alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor,” but only “to the extent such alleged liability arises by reason of” one of the following four relationships with the debtor:

- (I) the third party’s ownership of a financial interest in the debtor, a past or present affiliate of the debtor, or a predecessor in interest of the debtor;

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enjoining claims against the third party flowing from *pre*-bankruptcy activity. See Brubaker, *supra* note 173, at 962 n.3. And discharging post-filing lenders is similarly distinguishable. Accordingly, § 524(g)(3) is generally beyond the scope of this article. It should be noted, however, that some courts conflate the provisions granting third parties the protection of the supplemental injunction with the provisions granting immunity to successors and lenders. See, e.g., *In re Celotex Corp.*, 204 B.R. 586, 605-06 (Bankr. M.D. Fla. 1996).

<sup>395</sup> 11 U.S.C. § 524(g)(4)(A)(ii)(2006).

<sup>396</sup> *Id.* § 524(g)(4)(B)(ii) (providing that “the court determines, before entering the order confirming such plan, that identifying such debtor or debtors, or such third party (by name or as part of an identifiable group), in such injunction with respect to such demands for purposes of this subparagraph is fair and equitable with respect to the persons that might subsequently assert such demands, in light of the benefits provided, or to be provided, to such trust on behalf of such debtor or debtors or such third party”).

<sup>397</sup> *Id.*; see, e.g., *In re Kaiser Aluminum Corp.*, No. 02-10429(JKF), 7312, 2006 WL 616243, at \*17 (Bankr. D. Del. Feb. 6, 2006) (confirming plan where it appears the protected third parties contributed nothing; all contributions were made on their behalf by the reorganized debtors), *aff’d*, 343 B.R. 88 (D. Del. 2006); *In re J T Thorpe Co.*, 308 B.R. 782, 790-91 (Bankr. S.D. Tex. 2003) (confirming plan with supplemental injunction that shielded various non-debtor parties related to the debtor because the debtor’s parent company made contributions on behalf of the related parties, satisfying § 524(g)(4)(B)(ii)), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003), *aff’d*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004).

<sup>398</sup> It should be noted that § 524(g)(4) does not expressly limit the third-party claims that may be enjoined to *asbestos* claims. See 11 U.S.C. § 524(g)(4)(A) (2006). However, the overall structure of the statute, the purpose of the act, and the legislative history, plainly establish such a limitation. See, e.g., 140 CONG. REC. S4523 (daily ed. Apr. 20, 1994) (remarks of Sen. Graham) (“Mr. President, upon the establishment of a trust to pay asbestos claims, the bankruptcy court may enjoin claims against the debtor and certain third parties *alleged to be liable for the asbestos claims* against the debtor, channeling such claims to the trust for payment.” (emphasis added)). And no court or commentator has suggested otherwise.

- (II) the third party's involvement in the management of the debtor or a predecessor in interest of the debtor, or service as an officer, director or employee of the debtor or a related party;
- (III) the third party's provision of insurance to the debtor or a related party;
- or
- (IV) the third party's involvement in a transaction changing the corporate structure, or in a loan or other financial transaction affecting the financial condition, of the debtor or a related party, including but not limited to—
- (aa) involvement in providing financing (debt or equity), or advice to an entity involved in such a transaction; or
- (bb) acquiring or selling a financial interest in an entity as part of such a transaction.<sup>399</sup>

A number of courts and commentators have concluded that the language of § 524(g) leaves many ambiguities.<sup>400</sup> Paragraph (4)(A)(ii) is no exception. However, this provision does offer rather clear guidance with respect to the enjoining of some types of claims.

First, § 524(g)(4)(A)(ii) only allows for the restraining of claims alleging that a non-debtor is “directly or indirectly liable *for the conduct of, claims against, or demands on the debtor.*”<sup>401</sup> This language suggests that supplemental injunctions may *not* extinguish rights against a third party arising from the *third party's independent conduct*. And several courts have adopted this understanding. For example, in *Combustion Engineering*,<sup>402</sup> the initial plan of reorganization channeled to the litigation trust the asbestos liabilities of two affiliates of the debtor, Basic and Lummus.<sup>403</sup> Some of the claims against these two entities flowed from products that they distributed on their own.<sup>404</sup> In other words, the claims were “wholly separate from any liability involving Combustion Engineering.”<sup>405</sup> The Third Circuit held that the “plain language” of § 524(g) prohibited the extension of the supplemental injunction to “these *non-derivative* third-party actions.”<sup>406</sup> The court explained that “§ 524(g)[(4)(A)(ii)] limits the situations where a channeling injunction may enjoin actions against third parties

<sup>399</sup> 11 U.S.C. § 524(g)(4)(A)(ii). The statute defines a related party to mean (1) past and present affiliates of the debtor, (2) the debtor's predecessors in interest, and (3) “any entity that owned a financial interest” in the debtor or the parties identified in (1) and (2). *Id.* § 524(g)(4)(a)(iii).

<sup>400</sup> *See, e.g.*, Brown, *supra* note 32, at 902 (“Unfortunately, Section 524(g) is not always a model of clarity, and its legislative history is sparse.”); Kenneth Pasquale & Arlene G. Krieger, *Combustion Engineering and the Interpretation of Section 524(g)*, 2007 ANN. SURV. OF BANKR. LAW Part I § 4, at 149 (explaining that § 524(g) “is a convoluted series of requirements” and that recent litigation “has exposed a number of significant ambiguities in the application” of the statute).

<sup>401</sup> 11 U.S.C. § 524(g)(4)(A)(ii).

<sup>402</sup> *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004).

<sup>403</sup> *Id.* at 201.

<sup>404</sup> *Id.* at 231 (“By contrast, the asbestos-related personal injury claims asserted against Combustion Engineering, Basic, and Lummus arise from different products, involved different asbestos-containing material, and were sold to different markets.”).

<sup>405</sup> *Id.* at 235.

<sup>406</sup> *Id.* (emphasis added).

to those where a third party has *derivative* liability for the claims against the debtor.”<sup>407</sup>

Similarly, it appears clear that the supplemental injunction is allowed to bar claims seeking to hold a parent company or manager of the debtor responsible for the debtor’s asbestos liabilities by piercing the corporate veil.<sup>408</sup> Courts and commentators frequently describe veil piercing as creating a type of “indirect liability.”<sup>409</sup> And section 524(g) permits the enjoining of actions asserting that a third party is “directly or indirectly liable” by reason of “the third party’s ownership of a financial interest in the debtor” or “the third party’s involvement in the *management* of the debtor.”<sup>410</sup>

There is also little question that the channeling injunction may prohibit actions against insurance companies in which plaintiffs seek to recover under liability insurance policies the carriers sold to the debtor. The statute states that the injunction may bar lawsuits alleging that a third party is directly or indirectly liable by reason of its “provision of insurance to the debtor or a related party.”<sup>411</sup> Moreover, this was the precise type of claim released in *Johns-Manville*,<sup>412</sup> the bankruptcy upon which § 524(g) is based.

A more difficult case than these three examples concerns the liability of joint tortfeasors. Suppose asbestos claimants seek to hold a senior manager of the debtor liable because he was involved in the debtor’s tortious activity. It is well established that directors and officers are personally liable for corporate torts if they participate in the wrongful conduct.<sup>413</sup> The claimants would, in

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<sup>407</sup> *Id.* at 234 (emphasis added); *accord In re Federal-Mogul Global, Inc.*, No. 01-10578, 2008 WL 4493519, \*8-9 (Bankr. D. Del. Sept. 30, 2008) (holding that § 524(g) supplemental injunction could not be extended to two entities whose asbestos liabilities arose from their own conduct and did “not derive in any way from liability of the Debtors”; the two entities were “not alleged to be liable for the ‘conduct of’, claims against’, or ‘demands on’ the Debtors”); *In re Quigley Co.*, No. 04-15739(SMB), 2008 WL 2097016, at \*6, \*8 (Bankr. S.D.N.Y. May 15, 2008) (holding that claims against the debtor’s parent could be enjoined under § 524(g) because the claims sought to hold the parent vicariously liable for the debtor’s conduct and “vicarious liability is a form of derivative liability”); *see also* 140 CONG. REC. S4523 (daily ed. Apr. 20, 1994) (remarks of Sen. Graham) (“Mr. President, upon the establishment of a trust to pay asbestos claims, the bankruptcy court may enjoin claims against the debtor and certain third parties alleged to be liable for the asbestos claims *against the debtor*, channeling such claims to the trust for payment.” (emphasis added)).

<sup>408</sup> *See In re Quigley*, 2008 WL 2097016 at \*6 (offering several examples of the types of derivative claims that can be enjoined pursuant to § 524(g), including “alter ego, piercing the corporate veil, domination and control, and *respondeat superior*” (emphasis in original)).

<sup>409</sup> *See, e.g.*, *U.S. v. Bestfoods*, 524 U.S. 51, 70 (1998) (referring to veil piercing as establishing “indirect, derivative liability”); Douglas G. Smith, *Piercing the Corporate Veil in Regulated Industries*, 2008 BYU L. REV. 1165, 1186 (contrasting direct liability with “the indirect liability that occurs where the corporate veil has been pierced”).

<sup>410</sup> 11 U.S.C. § 524(g)(4)(A)(ii), (ii)(I), (ii)(II) (2006) (emphasis added).

<sup>411</sup> *Id.* § 524(g)(4)(A)(ii)(III).

<sup>412</sup> *See supra* notes 148-53 and accompanying text.

<sup>413</sup> 3A WILLIAM M. FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 1135 (perm. ed., rev. vol. 2002).

essence, be asserting that the manager is a joint tortfeasor with the debtor.<sup>414</sup> There *is* language in § 524(g) that suggests that enjoining such an action is permissible. The statute provides that a supplemental injunction may bar claims against a third-party alleging that the third-party is “*directly or indirectly liable for the conduct of . . . the debtor*” by reason of “*the third party’s involvement in the management of the debtor . . . or service as an officer, director or employee of the debtor.*”<sup>415</sup> First, the hypothetical plaintiffs are charging the manager with *direct* tort liability. Second, while the liability flows from the manager’s own conduct, as was the case with Basic and Lummus in *Combustion Engineering*, that conduct is inseparable from the debtor’s because the manager’s actions *were* the debtor’s actions. Thus, the claims allege that the manager is liable *for the debtor’s conduct*. This distinguishes the manager from Basic and Lummus, whose conduct was completely independent. Third, and last, the manager’s liability “arises by reason of” his service as an officer of the debtor; it was only through such service that the manager was involved with the debtor’s torts.

I am not necessarily convinced by this reading.<sup>416</sup> But it does illustrate that the language of § 524(g) provides considerable basis for expanding the protection of the supplemental injunction beyond mere “derivative” liability of third parties. Because the statute permits the enjoining of claims that assert “direct” liability, the language may be construed to allow for the release of joint tortfeasor claims against directors and officers, corporate affiliates, and even insurance companies.<sup>417</sup>

Section 524(g)(4) contains additional ambiguities.<sup>418</sup> But my purpose here is not to definitively resolve all issues regarding the language of that provision.

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<sup>414</sup> See *id.* (noting that a plaintiff may hold liable as joint tortfeasors the corporation and a manager that participated in the act that caused the plaintiff’s injury).

<sup>415</sup> 11 U.S.C. § 524(g)(4)(A)(ii), (ii)(II) (emphasis added).

<sup>416</sup> It is also worth noting that there are probably very few individuals left comparable to my hypothetical manager given how long ago most asbestos torts took place.

<sup>417</sup> See 11 U.S.C. § 524(g)(4)(A)(ii)(I)-(III). In *Johns-Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52 (2d Cir. 2008), *rev’d on other grounds, Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195 (2009), the Second Circuit implicitly rejected my joint-tortfeasor argument. The court concluded that a § 524(g) supplemental injunction could not enjoin claims against insurers alleging that the carriers (1) influenced Manville’s failure to disclose the dangers of asbestos, and (2) violated a duty to disclose information about asbestos that they learned through their dealings with Manville. *Id.* at 58, 67-68. The court repeatedly described these claims as based on the insurers’ “independent” conduct or duties. See *id.* at 55, 64-65, 67. But the precise allegations, such as influencing Manville to not divulge material, suggest that the insurers were being prosecuted, at least in part, as joint tortfeasors. See *United States v. Union Corp.*, 277 F. Supp. 2d 478, 489 (E.D. Pa. 2003) (“Joint tortfeasors are parties who either act together in committing a wrong or whose acts, if independent of each other, unite to form a single injury.”).

<sup>418</sup> For example, some authorities suggest that § 524(g)(4)(A)(ii)(III) allows for extension of the supplemental injunction to parties that shared insurance with the debtor, in addition to those that sold insurance to the debtor. See, e.g., *In re Combustion Eng’g, Inc.*, 295 B.R. 459, 481 (Bankr. D. Del. 2003), *subseq. vacated on other grounds*, 391 F.3d 190 (3d Cir. 2005). At least one commentator has criticized this understanding. See Brubaker, BANKR. LAW LETTER, *supra* note 196, at 11 (asserting that, even if sharing insurance constitutes the “provision of insurance” for

Rather, I believe that the bulk of non-debtor releases granted in asbestos cases raise more pressing concerns than strict compliance with the terms of § 524(g)(4).

## VI. LIMITATIONS ON ASBESTOS NON-DEBTOR RELEASES

### A. The Varying Scope of Asbestos Non-Debtor Releases

Virtually all, if not all, plans of reorganization in asbestos bankruptcies contain third-party releases.<sup>419</sup> Many of these provisions enjoin claims that are firmly within the scope of § 524(g). For example, most of the plans shield insurers from claims arising from insurance policies that the carriers issued to the debtor,<sup>420</sup> consistent with § 524(g)(4)(A)(ii)(III). Most also prohibit the assertion

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purposes of paragraph (4)(A)(ii)(III), the non-debtors' liability in *Combustion* did not arise "by reason of" the shared-insurance relationship, as required by § 524(g)(4)(A)(ii) if the non-debtors are to be protected by the supplemental injunction). I think Professor Brubaker has the superior understanding. Another issue is whether the supplemental injunction may shield carriers, who have settled their coverage disputes with the debtor, from state-law contribution actions brought by non-settling insurers. Mark D. Plevin et al., *Where Are They Now, Part Five: An Update on Developments in Asbestos-Related Bankruptcy Cases*, 8-8 MEALEY'S ASB. BANKR. REP. 24, 10-11 (2009) [hereinafter Plevin et al., *Where Are They Now*]. In some cases, these contribution claims are channeled to the trust for payment. *Id.* Protecting the settling carrier is probably permissible in this circumstance because the non-settling insurer is essentially seeking to hold the settling carrier "indirectly liable for the conduct of . . . the debtor" by reason of its "provision of insurance to the debtor." 11 U.S.C. § 524(g)(4)(A)(ii), (ii)(III); see *In re W. Asbestos Co.*, 313 B.R. 832, 856 (Bankr. N.D. Cal. 2003) (adopting this understanding of (4)(A)(ii) & (ii)(III)). In other bankruptcies, the contribution claims are enjoined even though the non-settling carrier will not be paid anything by the trust. See, e.g., *In re W. Asbestos Co.*, 313 B.R. at 856. Section 524(g)(1)(B) provides that the supplemental injunction may bar claims "to be paid in whole or in part by a trust described in paragraph (2)(B)(i)." 11 U.S.C. § 524(g)(1)(B) (emphasis added). Some non-settling insurers have thus objected in cases where they will receive no payment from the trust. See, e.g., *In re W. Asbestos Co.*, 313 B.R. at 856; see also Plevin et al., *Where Are They Now, supra*, at 22 n.143 (collecting other examples). Despite the language in paragraph (g)(1)(B), which seems to give the non-settling carriers a compelling argument, at least one court has held that a supplemental injunction may enjoin their rights despite the lack of payment. See *In re W. Asbestos Co.*, 313 B.R. at 856.

For an excellent discussion of some of the ambiguities that plague § 524(g)(4)(A)(ii), see *In re Quigley Co.*, No. 04-15739(SMB), 2008 WL 2097016 (Bankr. S.D.N.Y. May 15, 2008). See, e.g., *id.* at \*5 (explaining that the phrase "arises by reason of" in § 524(g)(4)(A)(ii) is ambiguous).

<sup>419</sup> Every plan that I reviewed in preparing this article contained at least one such release.

<sup>420</sup> See, e.g., Third Amended Plan of Reorganization of A.P.I. Inc. (Nov. 21, 2005) as Modified at Confirmation at 30-31, *In re A.P.I. Inc.*, No. 05-30073 (Bankr. D. Minn. Dec. 6, 2006) [hereinafter A.P.I. Third Amended Plan]; *In re Kaiser Aluminum Corp.*, No. 02-10429(JKF), 7312, 2006 WL 616243, at \*15-\*16 (Bankr. D. Del. Feb. 6, 2006), *aff'd*, 343 B.R. 88 (D. Del. 2006); *In re J T Thorpe Co.*, No. 02-41487-H5-11, 2003 WL 23573844, at \*10-\*11 (Bankr. S.D. Tex. Jan. 17, 2003), *aff'd*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004); see also Plevin et al., *Where Are They Now, supra* note 418, at 11. ("Policyholder-debtors typically extend that relief in their Chapter 11 plans to insurers who have entered into settlement agreements with the debtor pre-confirmation. In some instances, plans allow insurers who settle post-confirmation to also be

of claims against (i) non-debtor parent and affiliate companies,<sup>421</sup> and (ii) directors and officers,<sup>422</sup> where the claimants seek to hold such parties liable for the debtor's conduct solely by reason of their status as corporate affiliates or managers of the debtor. These types of supplemental injunctions are consistent with §§ 524(g)(4)(A)(i)(I) and (II), respectively.

However, a significant number of asbestos releases contain expansive language that arguably extinguishes claims that are beyond the scope of § 524(g).<sup>423</sup> For example, in the bankruptcy of A.P.I. Inc., the non-debtor release in the reorganization plan extinguished all "Third Party Claims,"<sup>424</sup> a term defined to include every claim "based upon, *relating to*, arising out of, *or in any way connected with*" asbestos claims against the debtor.<sup>425</sup> Such language is likely broad enough to encompass joint-tortfeasor liability, rather than just the types of derivative liability that are well within the scope of the statute. To illustrate, a cause of action seeking to hold a parent company liable for asbestos harm as a joint-tortfeasor with the debtor clearly "relates" and is "connected" to asbestos claims against the debtor. Yet, despite the release's broad language, A.P.I.'s plan of reorganization was confirmed.<sup>426</sup> Likewise, in the J T Thorpe bankruptcy, the court released various third parties from claims against them that "were either *directly* or derivatively through the [d]ebtor . . . on the *same subject matter* as any Claims" against the debtor.<sup>427</sup> Language such as "directly" and "on

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protected by the court's § 524(g) injunction."); Esserman & Parsons, *supra* note 371, at 204 ("[I]nsurance companies are often protected by an § 524(g) injunction[.]"). Sometimes, the plan cites both § 524(g) and § 105(a) as the basis for the insurance releases. See *infra* notes 438-39 and accompanying text for a discussion of this point.

<sup>421</sup> See, e.g., *In re Porter Hayden Co.*, No. 02-54152-SD, 2006 WL 4667137, at \*4, \*6-\*7 (Bankr. D. Md. Jun. 30, 2006), *aff'd*, No. 06-201, 2006 WL 4672671 (D. Md. Jul. 7, 2006); *In re Kaiser Aluminum Corp.*, 2006 WL 616243, at \*15-\*16; *In re J T Thorpe Co.*, 308 B.R. 782, 790-91 (Bankr. S.D. Tex. 2003) (noting that the debtor's parent, Thorpe Corporation, and various affiliates were receiving protection under the supplemental injunction), *order entered by*, 2003 WL 23573844, at \*10-\*13 (Bankr. S.D. Tex. Jan. 17, 2003) (setting forth the terms of the supplemental and "third-party" injunctions), *aff'd*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004); see also Esserman & Parsons, *supra* note 371, at 204 ("Indeed, parent and affiliate companies . . . are often protected by an § 524(g) injunction[.]").

<sup>422</sup> See, e.g., *In re Porter Hayden Co.*, 2006 WL 4667137 at \*4, \*6-\*7; *In re Kaiser Aluminum Corp.*, 2006 WL 616243, at \*15-\*16; A.P.I. Third Amended Plan, *supra* note 420, at 14-15, 26-30.

<sup>423</sup> The precise scope of many of asbestos third-party releases is difficult to determine, a perhaps intentional feature of such provisions. See Brubaker, *supra* note 173, at 993 ("The driving force behind non-debtor releases seems to be a relentless desire to steadfastly avoid articulating and valuing what and whose claims are being released.")

<sup>424</sup> A.P.I. Third Amended Plan, *supra* note 420, at 28-29.

<sup>425</sup> *Id.* at 15 (emphasis added); see also *id.* at 3 (defining "Asbestos Claim" in sufficiently broad language to arguably encompass joint-tortfeasor claims; the definition of "Third-Party Claim" is potentially unnecessary).

<sup>426</sup> Order Confirming Third Amended Plan of Reorganization of A.P.I. Inc. (Nov. 21, 2005) as Modified at Confirmation, *In re A.P.I. Inc.*, No. 05-30073 (Bankr. D. Minn. Dec. 5, 2006).

<sup>427</sup> See *In re J T Thorpe Co.*, No. 02-41487-H5-11, 2003 WL 23573844, at \*9 (Bankr. S.D. Tex. Jan. 17, 2003), *aff'd*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004); *id.* at \*10-\*13 (setting forth the terms of the injunctions barring prosecution of any released claims; the terms offer additional detail on the parties actually protected). In comparison, the Porter Hayden plan of

the same subject matter” also probably includes joint-tortfeasor liability. But the J T Thorpe plan was confirmed as well.<sup>428</sup> And there are other examples.<sup>429</sup>

### B. Asbestos Non-Debtor Releases Issued Under §§ 105(a) and 1123(b)(6)

Given the ambiguities in § 524(g) and the breadth of many asbestos non-debtor releases, it is not surprising that courts and parties frequently cite § 105(a) as an alternative ground for granting an asbestos release. In numerous cases, the plan or confirmation order indicates that the supplemental injunction or other non-debtor release was issued pursuant to § 524(g) and § 105(a),<sup>430</sup> and there are even cases that cite to *just* § 105(a).<sup>431</sup>

If a third-party release in an asbestos case is conferred under § 105(a) (or § 1123(b)(6)) rather than § 524(g), it is subject to all of the legal principles discussed in Part IV above. First consider *general* non-debtor releases—i.e. releases that do not involve insurance. In *anti*-release jurisdictions, general releases are beyond the power of the court.<sup>432</sup> And judges abiding by local precedent should strike such releases, as occurred in the Western Asbestos Company bankruptcy,<sup>433</sup> a case from the Northern District of California Bankruptcy Court, which falls within the anti-release Ninth Circuit.<sup>434</sup> Yet, this

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reorganization is much narrower, and the claims released fall well within the statute. The plan only shields the non-debtors from “Asbestos Bodily Injury Claim[s].” *In re Porter Hayden Co.*, 2006 WL 4667137, at \*4, \*6. There is no additional, general language, such as “relating to,” “connected with,” or “same subject matter.” *See id.* at \*6; *accord In re Armstrong World Indus., Inc.*, 348 B.R. 136, 153-54 (D. Del. 2006).

<sup>428</sup> *In re J T Thorpe Co.*, 2003 WL 23573844.

<sup>429</sup> *See, e.g., In re Federal-Mogul Global Inc.*, No. 01-10578, 2007 WL 4180545, \*33 (Bankr. D. Del. Nov. 16 2007) (“[T]he supplemental injunction enjoins all Entities that hold or assert claims, demands or causes of action against any of the Released Parties *relating in any way to any Claim against or Equity Interest in any of the Debtors*” (emphasis added)); *In re Celotex Corp.*, 204 B.R. 586, 606 (Bankr. M.D. Fla. 1996) (noting that the parties protected by the supplemental injunction include “any other Entity that is alleged to be co-liable with the Debtors and provides value to the Debtors or the Trust or any of the respective successors or assigns thereof”). Of course, sometimes the proponents of the plan realized that the contemplated non-debtor release goes beyond § 524(g), and thus they asked the court to grant the release solely pursuant to § 105(a). *See, e.g., In re Congoleum Corp.*, 362 B.R. 167, 189-91 (Bankr. D.N.J. 2007) (refusing to confirm the Chapter 11 plan and holding that the “sweeping” § 105(a) release contained therein was legally barred).

<sup>430</sup> *See, e.g., A.P.I. Third Amended Plan*, *supra* note 420, at 26-30; *In re U.S. Mineral Prods.*, No. 01-2471 (JKF), 2005 WL 5887219, \*6 (Bankr. D. Del. Dec. 29, 2005); *In re J T Thorpe Co.*, 2003 WL 23573844, at \*10-\*13.

<sup>431</sup> *See, e.g., Order Confirming the Joint Plan of Reorganization*, as of September 28, 2005, as Amended Through January 17, 2006, at 13-15, *In re The Babcock & Wilcox Co.*, No. 00-10992 (Bankr. E.D. La. Jan. 18, 2006).

<sup>432</sup> *See supra* notes 194-97 and accompanying text.

<sup>433</sup> *See In re W. Asbestos Co.*, 313 B.R. 832, 846-47 (Bankr. N.D. Cal. 2003) (pursuant to Ninth Circuit precedent, finding invalid a § 1123(b)(6) non-debtor release; the release purported to extinguish claims (1) based upon the non-debtors’ pre-petition operation or management of the debtor, but (2) unrelated to the bankruptcy case).

<sup>434</sup> *See Resorts Int’l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995) (§ 524(e) prohibits non-debtor releases).

does not always happen. Some courts bound by anti-release authority have upheld § 105(a) releases.<sup>435</sup> In my view, the pro-release authorities have the better position. Thus, I believe that general asbestos releases are, indeed, permissible under § 105(a) (and § 1123(b)(6)).<sup>436</sup> But such releases are valid only if they satisfy the *Master Mortgage* test, or (I would contend) my modified version of it. And virtually every decision I reviewed that upheld a § 105(a) release—including decisions from pro-release, anti-release, and open jurisdictions—made no such finding.<sup>437</sup>

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<sup>435</sup> For example, the Fifth Circuit is an anti-release jurisdiction. *Feld v. Zale Corp. (In re Zale)*, 62 F.3d 746, 760 (5th Cir. 1995) (“Section 524[(e)] prohibits the discharge of debts of non-debtors,” and thus § 105(a) may not be used to grant non-debtor releases). But in the J T Thorpe reorganization, a bankruptcy court located in the Southern District of Texas entered third-party releases pursuant to § 524(g) and § 105(a). See *In re J T Thorpe Co.*, 308 B.R. 782, 791 (Bankr. S.D. Tex. 2003), order entered by, No. 02-41487-H5-11, 2003 WL 23573844, at \*10-\*13 (Bankr. S.D. Tex. Jan. 17, 2003), *aff'd*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004); see also *In re The Babcock & Wilcox Co.*, No. 00-10992, 2004 WL 4945985, at \*24-\*28 (Bankr. E.D. La. Nov. 9, 2004) (another case from within the Fifth Circuit approving of non-debtor releases entered under § 524(g) and § 105(a)), *vacated on other grounds*, No. Civ.A. 05-232, 2005 WL 4982364 (E.D. La. 2005); *In re Asbestos Claims Mgmt. Corp.*, 294 B.R. 663, 683-86 (N.D. Tex. 2003) (same).

<sup>436</sup> See Silverstein, *supra* note 6, at 19-20, 106-36.

<sup>437</sup> As indicated in the text, there are decisions relying upon § 105(a) as authority for a general, asbestos non-debtor release from (1) *pro-release* jurisdictions, (2) *anti-release* jurisdictions, and (3) jurisdictions where the circuit court has not yet made a definitive ruling on the subject of non-debtor releases (i.e., “open jurisdictions”). In only two of these cases did the court apply the *Master Mortgage* test.

*Pro-Release Jurisdictions.* My research uncovered just one opinion from a pro-release circuit that cited § 105(a) as a basis for a general asbestos release. See *In re Eagle-Picher Indus., Inc.*, 203 B.R. 256, 281 (S.D. Ohio 1996) (citing both § 524(g) and § 105(a)). The *Eagle-Picher* court did not apply the *Master Mortgage* test. *Id.* at 279-81. However, the test was first articulated only two years earlier, see *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 934-35 (Bankr. W.D. Mo. 1994), and the Sixth Circuit had not yet adopted either the pro-release position or the *Master Mortgage* test, see *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 656-58 (6th Cir. 2002) (stating that non-debtor releases are permissible pursuant to §§ 105(a) and 1123(b)(6) and adopting the *Master Mortgage* test). Therefore, this is not too surprising.

*Anti-Release Jurisdictions.* As noted in the immediately preceding footnote, three courts from the Fifth Circuit have ignored governing anti-release precedent and upheld asbestos releases issued in part under § 105(a). Two did not apply the *Master Mortgage* test. See *In re J T Thorpe Co.*, 308 B.R. at 788-91; *In re Asbestos Claims Mgmt. Corp.*, 294 B.R. at 683-86. The third did, and found the test satisfied. See *In re The Babcock & Wilcox Co.*, 2004 WL 4945985, at \*24-\*28. The opinion in *In re The Babcock & Wilcox Co.*, was vacated on appeal because the parties reached a settlement. That settlement led to a revised Chapter 11 plan that was ultimately confirmed and that also cited § 105(a) as the entire or partial basis for two asbestos non-debtor releases. Order Confirming the Joint Plan of Reorganization, as of September 28, 2005, as Amended Through January 17, 2006, at 11-15, *In re The Babcock & Wilcox Co.*, No. 00-10992 (Bankr. E.D. La. Jan. 18, 2006).

Next consider *insurance* non-debtor releases in asbestos cases. Some courts and reorganization plans have cited § 105(a)—either in conjunction with § 524(g)<sup>438</sup> or by itself<sup>439</sup>—as authority for such releases. If § 105(a) is genuinely the basis for an insurance release, then courts contemplating such relief must address all of the complexities regarding insurance releases discussed in Part IV.B. However, if there is any type of non-debtor release that § 524(g) almost certainly authorizes, it is an insurance release. Accordingly, despite frequent references to § 105(a), insurance third-party releases in asbestos cases are best understood as flowing from § 524(g).

In sum, non-debtor releases issued pursuant to § 105(a) or § 1123(b)(6) in asbestos bankruptcies—i.e., *general* releases only, not *insurance* releases—are either invalid or, in my view, must satisfy the *Master Mortgage* test, including the requirement that all dissenting claimants receive payment in full on the released causes of action. Few plans of reorganization in asbestos cases have promised payment in full on claims extinguished by third-party releases.<sup>440</sup> This may flow from the fact that courts frequently rely upon both § 524(g) and § 105(a), or just § 524(g), as authority for the release. But as will be shown in the next part, the requirement of payment in full applies to § 524(g) releases as well.

### C. Asbestos Non-Debtor Releases Issued Under § 524(g)

Under the case law in both pro and anti-release jurisdictions, asbestos non-debtor releases that extend beyond the powers conferred by § 524(g) must, at the very least, provide payment in full on the extinguished claims. I firmly support

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*Open Jurisdictions.* The Third and Eighth Circuits have not yet taken a side in the debate over non-debtor releases. But there are lower court opinions from both circuits approving of § 105(a) asbestos releases without considering the *Master Mortgage* elements. See, e.g., *In re U. S. Mineral Prods.*, No. 01-2471 (JKF), 2005 WL 5887219, at \*6 (Bankr. D. Del. Dec. 29, 2005) (granting a § 105(a) injunction, but failing address to the *Master Mortgage* test); *In re U.S. Mineral Prods.*, No. 01-2471 (JKF), 2005 WL 5898300 (Bankr. D. Del. Nov. 29, 2005) (also failing to address the *Master Mortgage* elements); A.P.I. Third Amended Plan, *supra* note 420, at 30-31 (providing for non-debtor releases to be granted under § 524(g) and § 105(a)); Order Confirming Third Amended Plan of Reorganization of A.P.I. Inc. (Nov. 21, 2005) as Modified at Confirmation at 11-16, *In re A.P.I. Inc.*, No. 05-30073 (Bankr. D. Minn. Dec. 5, 2006) (issuing two injunctions under §§ 524(g) and 105(a) that constitute non-debtor releases, but nowhere addressing the *Master Mortgage* elements). But see also *In re Combustion Eng'g, Inc.*, 295 B.R. 459, 480-85 (Bankr. D. Del. 2003) (after finding that two non-debtors could not be protected by a § 524(g) channeling injunction from claims that were “independent” of the debtor because such claims were outside the scope of the § 524(g), the court concluded that a § 105(a) non-debtor release was impermissible as well because the *Master Mortgage* “Dow” factors were not satisfied), *subseq. vacated*, 391 F.3d 190, 210-11 (3d Cir. 2004) (explaining that the bankruptcy court subsequently found that the *Master Mortgage* “Dow” factors were met).

<sup>438</sup> See, e.g., A.P.I. Third Amended Plan, *supra* note 420, at 30-31; *In re W. Asbestos Co.*, 313 B.R. 456, 462, 465-66 (Bankr. N.D. Cal. 2004), *aff'd*, No. 3:03-CV-00989 MJJ, 2004 WL 1944792 (N.D. Cal. Apr. 16, 2004); *In re J T Thorpe Co.*, 2003 WL 23573844, at \*10-\*11.

<sup>439</sup> See, e.g., *In re Federal-Mogul Global Inc.*, No. 01-10578, 2007 WL 4180545, \*33-\*34 (Bankr. D. Del. Nov. 16, 2007); *In re Porter Hayden Co.*, No. 02-54152-SD, 2006 WL 4667137, at \*7-\*8 (Bankr. D. Md. Jun. 30, 2006), *aff'd*, No. 06-201, 2006 WL 4672671 (D. Md. Jul. 7, 2006).

<sup>440</sup> See *infra* notes 469-72 and accompanying text.

this conclusion. In this part, I argue, among other things, that a similar requirement applies to releases that fall *within* the scope of the statute. Section 524(g) displaced many of the legal requirements applicable to non-debtor releases issued outside the asbestos context. But it did not moot all of them. And one of the principles that is still applicable is the final element of both the *Master Mortgage* test and my modified version of the test—the mandate that the plan of reorganization promise full payment to dissenting creditors.

### 1. The Relationship of § 524(g) to General Non-Debtor Release Law

Section 524(g) significantly altered the law governing non-debtor releases in asbestos insolvencies. To begin with, the specific authorization to issue third-party releases contained in the statute makes the circuit split over the legality of non-debtor releases irrelevant to any release validly granted pursuant to § 524(g). Recall that the judicial debate over third-party releases in non-asbestos cases centers on §§ 105(a), 1123(b)(6), and 524(e).<sup>441</sup> The explicit sanctioning of third-party releases in § 524(g) eliminates any need to rely on the two equitable statutes as a basis for such relief.<sup>442</sup> And § 524(g) expressly states that courts may grant supplemental injunctions shielding non-debtors “[n]otwithstanding the provisions of section 524(e).”<sup>443</sup>

Section 524(g) also moots or displaces (1) most of the *Master Mortgage* test that pro-release courts use to assess the validity of releases, and (2) at least one piece of my Modified *Master Mortgage* test.<sup>444</sup> Under element two of both tests, the release must be “essential” to the reorganization. And under element three of the courts’ version, the benefitting releasee has to contribute substantial assets to the reorganization plan. These two standards flow from §§ 105(a) and 1123(b)(6), which, again, are not implicated by channeling injunctions in asbestos cases. Moreover, § 524(g) contains substitute requirements for both components. The element that requires essentiality is replaced by the mandate that without the injunction, the plan cannot “deal equitably with claims and future demands.”<sup>445</sup> And the “substantial contribution” element is replaced by the requirement that the injunction be fair and equitable “in light of the benefits provided” on behalf of the protected third party.<sup>446</sup> Similarly, the fifth piece of the *Master Mortgage* test, that “all or substantially all” parties impacted by the release receive payment in full, is likely also derived from the two equitable statutes, and thus no longer relevant to asbestos releases. Finally, the § 524(g) condition that seventy-five percent of the voting asbestos claimants cast their

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<sup>441</sup> See *supra* notes 190-97 and accompanying text.

<sup>442</sup> For a discussion of why § 524(g) clearly does not displace any authority bankruptcy courts possess to issue non-debtor releases under §§ 105(a) and 1123(b)(6) outside the asbestos context, see *supra* note 196.

<sup>443</sup> 11 U.S.C. § 524(g)(4)(A)(ii) (2006).

<sup>444</sup> The elements of the *Master Mortgage* test and my Modified *Master Mortgage* test that I discuss in the next several paragraphs are explained at *supra* notes 200-31 and accompanying text.

<sup>445</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(III).

<sup>446</sup> *Id.* § 524(g)(4)(B)(ii).

ballot in favor of the plan<sup>447</sup> displaces element four of the *Master Mortgage* test, which provides that the parties impacted by a release must “overwhelmingly consent” to the plan of reorganization.

Between the original *Master Mortgage* test and my modified version, there are three elements left to consider vis-à-vis § 524(g): (1) the third party has an “identity of interest” with the debtor such that prosecuting the claims otherwise scheduled for release could impact the estate (the first element of both tests); (2) the class of creditors impacted by the non-debtor release accepts the plan pursuant to § 1126(c)<sup>448</sup> (the third element of my test); and (3) the plan promises payment in full to dissenting creditors on any claims extinguished by the release (the final element of both tests).

*The Identity-of-Interest Element.* The identity-of-interest requirement concerns subject matter jurisdiction. If the debtor and the released third party do not have an identity of interest, any lawsuit against the third party will have no impact on the estate, placing the underlying claim beyond the jurisdiction of the bankruptcy court. Subject matter jurisdiction is an absolute prerequisite to any judicial order.<sup>449</sup> A bankruptcy court may thus not enjoin a claim outside its jurisdiction. Accordingly, the identity-of-interest element still applies to asbestos non-debtor releases even when they are granted pursuant to § 524(g).<sup>450</sup> Yet very

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<sup>447</sup> *Id.* § 524(g)(2)(B)(ii)(IV)(bb).

<sup>448</sup> *Id.* § 1126(c).

<sup>449</sup> *Ins. Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 701 (1982) (“The validity of an order of a federal court depends upon that court’s having jurisdiction over both the subject matter and the parties.”); *Comm. v. Dennis Reimer Co., L.P.A.*, 150 F.R.D. 495, 498 (D. Vt. 1993) (observing that subject matter jurisdiction “is a statutory and constitutional prerequisite to a court’s ability to entertain a legal action”).

<sup>450</sup> *See In re The Babcock & Wilcox Co.*, No. 00-10992, 2004 WL 4945985, at \*24 (Bankr. E.D. La. Nov. 9, 2004) (assessing the identity-of-interest element with respect to a non-debtor release issued under both § 524(g) and § 105(a)), *vac. on other grounds*, No. Civ.A. 05-232, 2005 WL 4982364 (E.D. La. 2005); *see also In re Armstrong World Indus., Inc.*, 348 B.R. 136, 156 (D. Del. 2006) (in one sentence, finding that the court had subject matter jurisdiction to issue the § 524(g) channeling injunction).

Another jurisdictional issue deserves note. While the language of § 524(g) suggests that a supplemental injunction becomes valid either upon issuance *or affirmance* by the district court, 11 U.S.C. § 524(g)(3)(A) (2006), when the injunction protects third parties, the jurisdictional provisions of the Bankruptcy Code will often require more than traditional appellate review by the district court. To the extent bankruptcy courts possess subject matter jurisdiction over actions between non-debtors, they do so pursuant to their “related to” jurisdiction. *See* 28 U.S.C. § 1334(b) (2006) (providing that federal district courts have jurisdiction “of all civil proceedings arising under title 11, or arising in or *related to* cases under title 11” (emphasis added)); 28 U.S.C. § 157(a) (permitting “any or all” bankruptcy matters to be referred to bankruptcy courts); *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 n. 5 (1995) (“Proceedings ‘related to’ the bankruptcy include . . . suits between third parties which have an effect on the bankruptcy estate.”). However, absent consent of the parties, 28 U.S.C. § 157(c)(2), bankruptcy courts may not issue final judgments in related proceedings, *id.* at § 157(c)(1). Rather, “[i]n such proceeding[s] the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge’s proposed

few courts have addressed this requirement.<sup>451</sup> This is particularly problematic given a court's independent duty to assess whether it has subject matter jurisdiction.<sup>452</sup>

*The § 1126 Creditor Consent Element.* Acceptance of the plan under § 1126(c) by the class of creditors impacted by a third-party release was included in my Modified *Master Mortgage* test because it is clear that a non-debtor release granted pursuant to § 105(a) or § 1123(b)(6) can not survive cramdown. The same is true with respect to § 524(g) releases.

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findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.” *Id.* A non-debtor release is effectively a final judgment. *In re Digital Impact, Inc.*, 223 B.R. 1, 12 (Bankr. N.D. Okla. 1998) (holding that a non-debtor release “is equivalent to issuing a final adjudication of the merits” of the released claims); Brubaker, *supra* note 173, at 1070 (“A non-debtor release is not a mere status quo injunction; a non-debtor release effectively adjudicates the released non-debtor action. The release operates as an adjudication on the merits, fully binding for res judicata/preclusion purposes.”). Accordingly, any such release granted by the bankruptcy court—including a supplemental injunction issued under 11 U.S.C. § 524(g)—is subject to *de novo* review by the district court if a party impacted by the release objects on appeal. *See* Brubaker, *supra* note 173, at 1070 (“The non-debtor actions that are ‘adjudicated’ through non-debtor releases are, at best, non-core, ‘related to’ actions, beyond the power of a bankruptcy judge to determine by final order without consent of the litigants.”). *But see In re Celotex Corp.*, 204 B.R. 586, 608 (Bankr. M.D. Fla. 1996) (concluding that confirmation of plan with supplemental injunction barring claims against third parties is a core proceeding).

Alternatively, to avoid the waste of judicial resources resulting from duplicative assessment of a channeling injunction, the district court can withdraw the reference under 28 U.S.C. § 157(d) and grant the release itself, in the first instance, as contemplated by § 524(g)(3)(A). *See* Brubaker, *supra* note 173, at 1070 n.432 (“Limitations on a bankruptcy court’s core jurisdiction are not implicated where the district court enters the final order approving non-debtor release and injunction provisions.”); *e.g.*, *In re Burns & Roe Enter., Inc.*, No. 08-4191 (GEB), 2008 WL 4280099, at \*1 (D.N.J. Sept. 15, 2008) (withdrawing the reference for the confirmation hearing “in the interest of judicial economy” so that the district court judge, sitting jointly with the bankruptcy judge, could consider the debtor’s proposed § 524(g) channeling injunction).

<sup>451</sup> *See, e.g., In re Porter Hayden Co.*, No. 02-54152-SD, 2006 WL 4667137 (Bankr. D. Md. Jun. 30, 2006), *aff’d*, No. 06-201, 2006 WL 4672671 (D. Md. Jul. 7, 2006) (neither opinion discusses the identity-of-interest requirement); *In re Kaiser Aluminum Corp.*, No. 02-10429(JKF), 7312, 2006 WL 616243, at \*13-\*18 (Bankr. D. Del. Feb. 6, 2006) (addressing the identity-of-interest requirement with respect to a § 105(a) non-debtor release, but not with respect to the § 524(g) channeling injunction), *aff’d*, 343 B.R. 88 (D. Del. 2006); *In re J T Thorpe Co.*, 308 B.R. 782 (Bankr. S.D. Tex. 2003), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003), *aff’d*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004). There are also courts that applied the identity-of-interest requirement but apparently thought it was not a prerequisite to jurisdiction, just one possible jurisdictional ground. *See In re U.S. Mineral Prods. Co.*, No. 01-2471 (JKF), 2005 WL 5898300, at \*14 (Bankr. D. Del. Nov. 29, 2005) (finding that each beneficiary of the releases and injunctions “shares an identity of interest with the Debtor . . . , or was instrumental to the successful prosecution and conclusion of the Chapter 11 Case, provided necessary funding to the Debtor, and/or has contributed substantial assets or other benefits to the Debtor’s reorganization” (emphasis added)); *In re ABB Lummus Global, Inc.*, No. 06-10401-JKF, 2006 WL 2052409, at \*20 (Bankr. D. Del. Jun. 29, 2006) (same).

<sup>452</sup> *Royal Ins. Co. of Am. v. Caleb V. Smith & Sons, Inc.*, 929 F. Supp. 606, 606 (D. Conn. 1996) (“A federal district court has a duty to independently determine whether it has jurisdiction to consider a case before it.”) (citing *Ins. Corp. of Ireland*, 456 U.S. at 720).

As noted previously, the general requirements for confirmation apply to any Chapter 11 plan that contains a § 524(g) channeling injunction.<sup>453</sup> Thus, in asbestos cases involving § 524(g), as in other bankruptcies, it is necessary to satisfy the requirement that either (1) every impaired class consent under § 1126(c), *or* (2) the plan be confirmable via a cramdown over the objection of any impaired, dissenting class.<sup>454</sup> There is no reason to believe that a § 524(g) non-debtor release is more amenable to cramdown than a § 105(a) release. Indeed, the Third Circuit has ruled that *no* § 524(g) channeling injunction may be crammed down, whether it protects third parties or not.<sup>455</sup> Therefore, as with non-asbestos third-party releases, the class of asbestos claimants impacted by any § 524(g) release must accept the plan under § 1126(c).<sup>456</sup>

Section 1126(c) is satisfied when, among voting members of the class, at least two-thirds in dollar amount and more than one-half in number approve of the plan.<sup>457</sup> The second part of this standard is substantially mooted by the requirement in § 524(g) that at least *seventy-five percent* of voting asbestos claimants approve of the plan.<sup>458</sup> But the first part of § 1126(c) is a distinct requirement that must still be satisfied. A plan is thus unconfirmable unless at

<sup>453</sup> See *supra* notes 367-69 and accompanying text.

<sup>454</sup> See 11 U.S.C. §§ 1129(a)(8)(A), 1129(b)(1); see also 7 COLLIER ON BANKRUPTCY ¶ 1124.01, at 1124-3 (15th ed. rev. 2003) (“A class of claims is impaired under § 1124 if the plan alters the legal, equitable or contractual rights to which holders of such claims are otherwise entitled.”); *id.* ¶ 1124.02, at 1124-5 (“Any alternation of these rights constitutes impairment, even if the value of the rights is *enhanced*.” (emphasis added)) (collecting authorities).

<sup>455</sup> See *Century Indem. Co. v. Congoleum Corp. (In re Congoleum Corp.)*, 426 F.3d 675, 680 n.4 (3d Cir. 2005) (“Pre-packaged bankruptcies employing a [§ 524(g)] channeling injunction are not eligible for the ‘cram down’ provision contained in 11 U.S.C. § 1129(b)(1) which allows the bankruptcy court to confirm a plan of reorganization over creditors’ objections in certain circumstances.”).

<sup>456</sup> In addition, when a supplemental injunction extinguishes claims against third parties, there is a compelling argument that asbestos claimants with rights against both the debtor and the released third parties must be placed in a distinct class (or subclass). Including them in a class with tort claimants who possess rights against *only the debtor* is inconsistent with the classification and treatment principles set forth in 11 U.S.C. §§ 1122(a), 1123(a)(4). See Brubaker, *supra* note 173, at 983 (making this point in the context of *non-asbestos* third-party releases); see also *id.* at 976-77 n.61 (arguing that subclassification of future claims, separating those with rights against the debtor and third parties from those with rights against only the debtor, is necessary under § 524(g)(2)(b)(ii)(bb) to avoid “irreconcilable conflicts” of interest); *id.* at 981-86 (arguing that *non-asbestos* third-party releases frequently corrupt the integrity of class formation and treatment because courts do not take the extinguished non-debtor claims into account in analyzing whether the plan of reorganization satisfies §§ 1122(a) and 1123(a)(4)). Such separate classification is consistent with the language of § 524(g) which mandates that “a separate class *or classes* of [asbestos] claimants . . . [be] established.” 11 U.S.C. § 524(g)(2)(b)(ii)(BB) (emphasis added). *But cf. In re Congoleum Corp.*, 362 B.R. 167, 182 (Bankr. D.N.J. 2007) (placing the asbestos claimants in four distinct classes rendered “the Plan unconfirmable on its face”). Thus, the class that must consent under § 1126(c) to any § 524(g) non-debtor release is the distinct class of asbestos claimants with rights extinguished by the release.

<sup>457</sup> 11 U.S.C. § 1126(c).

<sup>458</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb).

least two-thirds in value of the voting asbestos claimants impacted by any third-party release vote in favor of the plan.<sup>459</sup> In theory, this should prevent the votes of large numbers of parties with smaller tort claims from overwhelming the votes of those with more serious personal injuries.<sup>460</sup> However, some commentators have observed that it does not always work out this way in practice.<sup>461</sup>

*The Payment-in-Full Element.* The requirement that the reorganization plan promise all dissenting creditors payment in full on any claims extinguished by a § 105(a) or § 1123(b)(6) non-debtor release was included in my Modified *Master*

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<sup>459</sup> An excellent example is the Quigley bankruptcy. See *In re Quigley Co.*, 346 B.R. 647, 653-59 (Bankr. S.D.N.Y. 2006) (holding that the class of personal injury asbestos claimants did not accept the plan; eighty-five percent *in number* of those voting did so in favor of the plan, well more than the fifty-percent requirement of § 1126(c) and the seventy-five percent requirement of § 524(g)(2)(B)(ii)(IV)(bb); but only either sixty-five percent or fifty-two percent *in dollar amount* (the court used two different measures) of those voting did so in favor of the plan, both of which were less than the two-thirds requirement of § 1126(c)); *In re Quigley Co.*, 377 B.R. 110, 114-15 (Bankr. S.D.N.Y. 2007) (explaining that the debtor's plan could not be confirmed because the asbestos claimants failed to accept the plan under § 1126(c), as outlined in the previous parenthetical); see also *In re Kaiser Aluminum Corp.*, No. 02-10429(JKF), 7312, 2006 WL 616243, at \*2, \*10, \*15 (Bankr. D. Del. Feb. 6, 2006) (separately addressing the requirement of § 1129(a)(8), which incorporates § 1126(c), and § 524(g)(2)(B)(ii)(IV)(bb)), *aff'd*, 343 B.R. 88 (D. Del. 2006); *In re J T Thorpe Co.*, 308 B.R. 782, 785, 787-89 (Bankr. S.D. Tex. 2003) (separately addressing the requirements of §§ 1126(c) and § 524(g)(2)(B)(ii)(IV)(bb)), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003), *aff'd*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004); Plevin et al., *Future Claims Representative*, *supra* note 32, at 285 n.72 (noting that the seventy-five percent requirement is "in addition to" the two-thirds mandate of § 1126(c)).

<sup>460</sup> See the discussion of the *Quigley* bankruptcy *supra* note 459. See also Brown, *supra* note 32, at 859-60 ("[G]iven the wide disparity among the potential values of asbestos claims, it is possible that a large block of low-value claimants will vote in favor of a plan (thereby satisfying the supermajority "number of claimants" requirement of Section 524(g)) while a much smaller number of high-value claimants will vote against the plan (thereby preventing the plan from satisfying the two-thirds "value of claims" requirement of Section 1126(c)).").

<sup>461</sup> See Mark D. Taylor, *As the Wave of Asbestos Bankruptcies Recedes: What Have We Learned?*, 6-12 MEALEY'S ASB. BANKR. REP. 22, 1 (2007) (discussing how large number of unimpaired claims controlled the vote in many asbestos bankruptcies); Plevin et al., *Future Claims Representative*, *supra* note 32, at 285 n.73 (explaining that, because courts generally weight all asbestos claims at one dollar per claim for voting purposes, the large numbers of unimpaired claimants "can veto any plan that they . . . believe will not adequately provide for their interests," to the detriment of the smaller numbers of impaired claimants). Former Bankruptcy Judge Barliant and his co-authors have identified additional, related problems with the voting process in asbestos bankruptcies. In some reorganizations, tort plaintiffs who settled with the debtor pre-petition are permitted to vote on the plan. This enables the plan proponents to essentially buy some of the votes necessary to reach the seventy-five percent threshold of § 524(g)(2)(B)(ii)(IV)(bb). Barliant, *supra* note 32, at 462-64; see, e.g., *In re Quigley Co.*, 377 B.R. at 113. In other cases, claims arising after a specified cut-off date, but prior to the filing of the Chapter 11 petition, have been denied the right to vote on the plan. Barliant, *supra* note 32, at 458-62.

*Mortgage* test because of the best interests of creditors test.<sup>462</sup> Pursuant to the best interests test, which is contained in § 1129(a)(7), a Chapter 11 reorganization plan is confirmable only if it provides each dissenting, impaired creditor at least as much as the claimant would be paid if the debtor liquidated under Chapter 7.<sup>463</sup> Third-party releases are impermissible in Chapter 7 cases.<sup>464</sup>

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<sup>462</sup> See Silverstein, *supra* note 6, at 76-77. The pro-release courts have never articulated their basis for adding this element to the original *Master Mortgage* test.

<sup>463</sup> 11 U.S.C. § 1129(a)(7)(A) (2006); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7], at 1129-45 (15th ed. rev. 2004) (explaining that the test “is an individual guaranty to each creditor or interest holder that it will receive at least as much in reorganization as it would in liquidation”). Unlike the cram-down provisions in § 1129(b), which protect *classes* of creditors, see *In re Sentry Operating Co.*, 264 B.R. 850, 865 (Bankr. S.D. Tex. 2001), the best interests test protects *individual* creditors (and individual holders of equity interests), see *In re Cajun Elec. Power Coop., Inc.*, 230 B.R. 715, 741 (Bankr. M.D. La. 1999) (the best interests test “is designed to protect those individual creditors who voted against a particular plan, but who, nonetheless, are being bound to such plan.”); 7 COLLIER ¶ 1129.03[7][b], at 1129-46 (“Section 1129(a)(7) operates on an individual creditor or interest holder level.”). This means that each creditor (and each holder of an equity interest) has “a limited veto power over the terms of a chapter 11 plan.” CHARLES J. TABB & RALPH BRUBAKER, BANKRUPTCY LAW: PRINCIPLES, POLICIES, AND PRACTICE 775 (2d ed. 2006) [hereinafter TABB]; accord 7 COLLIER ¶ 1129.03[7][b], at 1129-46 (The best interests test “renders irrelevant class votes if but one [dissenting] member of that class would get less than their liquidation preference under the plan.”).

The best interests test reflects one of the foundational precepts of Chapter 11: The debtor’s various constituencies are free to negotiate and formulate a plan of reorganization via the structures of Chapter 11; however, the final product of this process may not deprive any objecting creditor or interest-holder of its direct financial stake in the debtor—i.e., its rights upon liquidation of the debtor—without that person’s consent. See TABB, *supra*, at 775. Put another way, “the Code assumes that any value over and above liquidation value is subject to negotiation and debate, and its allocation subject to group vote rather than individual demand.” 7 COLLIER ¶ 1129.03[7][b], at 1129-45 to 1129-46. But each creditor’s entitlement to liquidation value is “inviolable.” Brubaker, *supra* note 173, at 992. See generally 7 COLLIER ¶ 1129.03[7] (providing an extensive overview of the best interests test); Natalic Regoli, *Confirmation of Chapter 11 Bankruptcy: A Practical Guide to the Best Interest of Creditors Test*, 41 TEX. J. BUS. LAW 7 (2005) (same); FERRIEL & JANGER, *supra* note 174, at 764-67 (providing a brief overview of the best interests test).

In deciding whether the best interests of creditors test is satisfied in a given case, the court must “conjure up a hypothetical chapter 7 liquidation that would be conducted on the effective date of the plan. The court then makes an independent finding, based on the evidence and arguments presented, whether creditors will receive as much under the plan as they would in the hypothetical Chapter 7 liquidation.” *In re Affiliated Foods, Inc.*, 249 B.R. 770, 787 (Bankr. W.D. Mo. 2000) (citations and internal quotation marks omitted); accord *In re Sierra-Cal*, 210 B.R. 168, 172 (Bankr. E.D. Cal. 1997). In assessing what would occur in the hypothetical liquidation, “it is generally agreed that all provisions applicable in a chapter 7 liquidation are to be taken into account.” *In re Sierra-Cal*, 210 B.R. at 174. Thus, the bankruptcy court must, *inter alia*, apply the Chapter 7 distribution scheme, *id.* at 172, as set forth in 11 U.S.C. § 726(a) (2006) (stating the order of priority in a Chapter 7 case). And the court must take “into account such matters as subordinations (11 U.S.C. § 510) and recoveries from general partners (11 U.S.C. § 723) that would be applied in a chapter 7 liquidation.” *In re Sierra-Cal*, 210 B.R. at 172; accord H.R. REP. No. 95-595, at 412-13 (1977), reprinted in 1977 U.S.C.C.A.N. 5963, 6368-69; see, e.g., *In re Sierra-Cal*, 210 B.R. at 174 (holding that the disallowance of claims under 11 U.S.C. § 502(d)

A creditor may thus recover any deficiency from a solvent co-obligor if the debtor's Chapter 7 distribution does not completely satisfy the creditor's claim.<sup>465</sup> Therefore, because the dissenting creditor would receive payment in full on its claim *in a Chapter 7 liquidation* from either the debtor, the co-obligor, or a

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"must be taken into account in the [best interests] test's hypothetical liquidation"). See generally 7 COLLIER ¶ 1129.03[7][c], at 1129-50 to 1129-55 (addressing various issues that arise in applying the best interests test as a result of the Chapter 7 distribution scheme and related provisions of Chapters 5 and 7 of the Code).

As part of the best interests analysis, the court typically reviews a "liquidation analysis" that summarizes how much creditors would receive if the debtor liquidated under Chapter 7, and compares the analysis to the payments contemplated by the debtor's Chapter 11 plan. See, e.g., *Kane v. Johns-Manville (In re Johns-Manville Corp.)*, 843 F.2d 636, 643 (1988) (explaining that at the confirmation hearing "Manville presented an extensive liquidation analysis based on documentary evidence and expert testimony," and that the bankruptcy judge "found that Class-4 present asbestos health claimants would receive 100% on their claims under the plan but would receive only 56%-81% in a liquidation"). Many authorities indicate that the plan proponents *must* present a liquidation analysis. See, e.g., *In re Adelpia Commc'ns, Corp.*, 361 B.R. 337, 366 (Bankr. S.D.N.Y. 2007) ("In order to show that a payment under a plan is equal to the value that the creditor would receive if the debtor were liquidated, there must be a liquidation analysis of some type[.]") (internal quotation marks omitted); 7 COLLIER ¶ 1129.03[7][b][iii], at 1129-47 (concluding that § 1129(a)(7)'s statutory language "essentially requires every plan proponent to perform a liquidation analysis of the estate"); see also Regoli, *supra*, at 24 n.58 (collecting authorities holding that a liquidation analysis is mandatory). Others indicate, however, that the court may dispense with a liquidation analysis in some circumstances. See, e.g., *In re AG Consultants Grain Div., Inc.*, 77 B.R. 665, 670 (Bankr. N.D. Ind. 1987) (holding that no liquidation analysis was necessary where it was "patently obvious" from the petition schedules and financial statements that unsecured creditors would receive less in a liquidation than under the debtor's plan); see also Regoli, *supra*, at 24 n.58 (collecting authorities finding that a liquidation analysis was unnecessary). When a liquidation analysis *is* conducted, it has to be "based on evidence and not mere assumptions or assertions," *In re Adelpia Commc'ns, Corp.*, 361 B.R. at 366, but it need not establish with high levels of certainty the value creditors would receive if the debtor proceeded with a Chapter 7 bankruptcy, *id.* at 366-67 ("However, the valuation of a hypothetical chapter 7 liquidation is, by nature, inherently speculative and is often replete with assumptions and judgments." (internal quotation marks omitted)); *In re Affiliated Foods, Inc.*, 249 B.R. at 788 ("The valuation of a hypothetical Chapter 7 for purposes of § 1129(a)(7) is not an exact science. The hypothetical liquidation entails a considerable degree of speculation about a situation that will not occur unless the case is actually converted to chapter 7." (internal quotation marks omitted)). For a summary of liquidation analyses, see 7 COLLIER ¶ 1129.03[7][b][iii], at 1129-47 to 1129-49; for a comprehensive overview, see Regoli, *supra*, at 23-39.

<sup>464</sup> Silverstein, *supra* note 6, at 73-74, 76 n.350 (collecting judicial and secondary authorities). *But cf. id.* at 74 n.338 (collecting judicial authorities granting releases in Chapter 11 liquidations).

<sup>465</sup> *Id.* at 76 & n.350; accord Brubaker, *supra* note 173, at 992 ("In a Chapter 7 liquidation proceeding, creditors retain their rights to pursue non-debtors for full payment, because there is no reorganization to protect by providing non-debtor releases."); see also Hydee R. Feldstein, *Reinterpreting Bankruptcy Code § 524(e): The Validity of Third-Party Releases in a Plan*, 22 CAL. BANKR. J. 25, 43 (1994) ("Where a creditor holds, or creditors generally hold, claims against a nondebtor, § 524(e) . . . would preserve those claims and they would survive a chapter 7 discharge of the debtor pursuant to § 524(a).").

combination of the two, the debtor's *Chapter 11 plan* must promise full payment to the dissenting creditor if the plan releases the co-liable third party.<sup>466</sup>

This reasoning is equally applicable to non-debtor releases granted under § 524(g). That statute only permits the issuance of a supplemental injunction "in connection with" an order "confirming a plan of reorganization under [C]hapter 11."<sup>467</sup> Section 524(g) channeling injunctions, protecting third parties or otherwise, are prohibited in Chapter 7 bankruptcies. Accordingly, as with other types of debtors, when an asbestos debtor liquidates through Chapter 7, its tort claimants are entitled to payment of any deficiency from solvent co-obligors. And thus, once again, because any dissenting asbestos claimant would receive full payment on its claim in a Chapter 7 proceeding from the debtor, the co-obligor, or a mix of each, the debtor's Chapter 11 plan must promise payment in full to the dissenting asbestos claimant if the plan releases the co-obligor.<sup>468</sup>

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<sup>466</sup> Silverstein, *supra* note 6, at 77 & n.351; accord Brubaker, *supra* note 173, at 991-94 (arguing that non-debtor releases violate the best interests of creditors test); *id.* at 992 ("[G]iving at least liquidation value to each creditor requires protection of the Chapter 7 right to pursue non-debtor actions."); Kenneth M. Lewis, *When are Nondebtors Really Entitled to a Discharge: Setting the Record Straight on Johns-Manville and A.H. Robins*, 3 J. BANKR. LAW AND PRAC. 163, 174-75 (1994) (arguing that a plan containing a non-debtor release does not satisfy the best interests test if co-obligors have sufficient assets to satisfy any deficiencies on the discharged claims); *see also* Feldstein, *supra* note 465, at 43 ("Accordingly, if the claims released . . . have any real value, then the best interest test requires realization of that value for the plan to be confirmed."); *cf.* Class Five Nev. Claimants v. Dow Corning Corp. (*In re Dow Corning Corp.*), 280 F.3d 648, 658 (6th Cir. 2002) (holding that non-debtor releases are permissible only when all dissenting creditors whose claims are extinguished by the release are paid in full under the debtor's plan); *In re Boyer*, 90 B.R. 200, 201 (Bankr. D.S.C. 1988) ("Because unsecured creditors would receive full payment if this were a chapter 7 case, they are entitled to full payment and interest if full payment in the chapter 11 case is not made as of the effective date of the plan."). As previously discussed, the same analysis applies to the release of independent claims against a third party. *See supra* note 223 and accompanying text. But this analysis is not pertinent to § 524(g) because, as explained *supra* at notes 401-07 and accompanying text, § 524(g) may not be used to extinguish independent claims against non-debtors. The statute may only be used to extinguish third-party claims when the third party and the debtor are co-obligors of some type.

<sup>467</sup> 11 U.S.C. § 524(g)(1)(A) (2006) (emphasis added).

<sup>468</sup> A crucial assumption of this argument, in either the non-asbestos or the asbestos context, is that, under the best interests test, it is mandatory to consider what a creditor would receive from both the debtor and the co-obligor if the debtor liquidated through Chapter 7. Professor Brubaker, the first commentator to fully develop how the best interests standard impacts non-debtor releases briefly addressed this point. *See* Brubaker, *supra* note 173, at 991-994. He argued that the language of § 1129(a)(7)(A)(ii) is not restricted to claims against the debtor: "It requires a comparison of what a holder would receive under the plan on account of an abstract 'claim' with the amount the holder would receive if the debtor were liquidated under Chapter 7." Brubaker, *supra* note 173, at 992 n.118. Thus, he concluded, "the best interests equation also properly mandates consideration of creditors' comparative recoveries on non-debtor claims, to the extent the plan is treating those non-debtor claims by release." *Id.* at 992. Obviously, I concur with Professor Brubaker's analysis. And there is general language in the case law that supports our understanding of the best interests test. *See, e.g., In re Zaruba*, 384 B.R. 254, 262 (Bankr. D. Alaska 2008) ("The best interests of creditors test requires that the debtor demonstrate that *creditors will fare* at least as well in Chapter

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11 as they would in Chapter 7.” (emphasis added)). However, there is also general language to the contrary. See, e.g., *In re Smith*, 357 B.R. 60, 67 (Bankr. M.D.N.C. 2006) (“Under section 1129(a)(7), absent consent, each creditor or interest holder in an impaired class must receive (i) property (ii) that has a present value equal to (iii) that participant’s *hypothetical chapter 7 distribution* (iv) if the debtor were liquidated instead of reorganized on the effective date of the plan.” (emphasis added)); *In re Lisanti Foods, Inc.*, 329 B.R. 491, 500 (Bankr. D.N.J. 2005) (“In making such a showing, the liquidation value of the debtor’s assets is controlling.” (emphasis added)); see also 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7], at 1129-46 (15th ed. rev. 2004) (“This means that, absent consent, a creditor . . . must receive property that has a present value equal to that participant’s *hypothetical chapter 7 distribution* if the debtor were liquidated instead of reorganized on the plan’s effective date.” (emphasis added)). None of the authorities containing these broad statements considered the application of the best interests test when the plan of reorganization contains a non-debtor release, and so their pertinence is questionable. Moreover, the only cases to address the relationship of the best interests test to non-debtor releases have implicitly sided with Professor Brubaker and me. See *Mercury Capital Corp. v. Milford Conn. Assocs.*, 354 B.R. 1, 9 (D. Conn. 2006) (reversing confirmation of debtor’s Chapter 11 plan and remanding with instructions to the bankruptcy court to consider whether the plan satisfied the best interest test; the district court’s concern was that the plan released a creditor’s claim against non-debtor guarantors, and thus the creditor “may be significantly less secured under the debtor’s plan than under a Chapter 7 liquidation”); *In re Conseco, Inc.*, 301 B.R. 525, 527-28 (Bankr. N.D. Ill. 2003) (explaining that the debtor’s prior plan of reorganization was not confirmable because it violated the best interests test by providing that creditors who were entitled to a Chapter 7 liquidation distribution had to release non-debtors in order to receive *any* payment under the Chapter 11 plan). Both *Mercury Capital Corp.* and *In re Conseco, Inc.*, support the proposition that, when a plan contains a third-party release, the best interest analysis must take account of distributions the releasing creditors would receive in Chapter 7 from the debtor *and the protected third parties*. See also *In re Boston Harbor Marina Co.*, 157 B.R. 726, 732 (Bankr. D. Mass. 1993) (“Indeed, because a chapter 7 trustee of [a] partnership may proceed against the partners individually, 11 U.S.C. § 723 (1988), the best-interest-of-creditors test . . . requires the court to find that creditors will receive at least as much from the partners’ contributions to the [partnership’s] plan as they would from the assertion of a chapter 7 trustee’s rights against the partners,” if the plan releases the partners.) (For reasons set forth later in this footnote, *Boston Harbor* is only *indirect* support for my position.)

Professor Brubaker does acknowledge in his article that many of the earlier pro-release authorities ignored “the creditors’ Chapter 7 right to seek full satisfaction from non-debtors in gauging satisfaction of the best interests test—comparing a creditor’s Chapter 11 distribution with a hypothetical Chapter 7 distribution, from the debtor *only*.” Brubaker, *supra* note 173, at 992; see also *id.* at 994 n.124 (offering as an example *In re A.H. Robins Co.*, 88 B.R. 742, 748 (E.D. Va. 1988), *aff’d*, 880 F.2d 694 (4th Cir. 1989)); TABB, *supra* note 463, at 776 (“In determining what the creditors and interest holders would receive in a chapter 7 liquidation, the courts generally limit their inquiry to what those parties would receive *in* the bankruptcy case itself. In other words, a court does not ask whether the creditor or interest holder would be better off overall if the debtors were to liquidate, but only compares the bankruptcy distributions in chapter 7 versus chapter 11.”). But, by generally adopting the Sixth Circuit’s addition to the *Master Mortgage* test—the requirement that all dissenting creditors impacted by a non-debtor release receive payment in full on the released claims—the pro-release authorities now implicitly accept the position held by Professor Brubaker and myself: When a plan contains a third-party release, the best interests test requires considering what the creditor would receive from the released party in the Chapter 7 case.

I must point out one decision that, while not addressing non-debtor releases, contradicts my position more directly than the authorities discussed in the first paragraph of this footnote. In *In re Dow Corning Corp.*, 237 B.R. 380, 411 (Bankr. E.D. Mich. 1999), the court stated that, when

applying the best interests test, the judge must consider what “the creditor would receive from the chapter 7 trustee—and only that amount—for comparison with the dividend available under the plan.” *Id.* at 411 (emphasis added). The *Dow* bankruptcy court justified this assertion by pointing to case law construing the Chapter 13 best interest of creditors test, *id.*, which is substantially similar to Chapter 11’s, compare 11 U.S.C. § 1325(a)(4) (2006), with *id.* § 1129(a)(7). The court explained that judicial authorities interpreting the Chapter 13 test “uniformly hold that amounts obtainable from other sources, such as guarantors, are irrelevant when performing that section’s best-interest-of-creditors test.” *In re Dow Corning Corp.*, 237 B.R. at 411 (emphasis added).

The Chapter 13 case law is not nearly as broad as the *Dow* court suggested. None of the authorities it cited involved guarantors or other non-debtors. All of the decisions concerned the impact of nondischargeable claims against the debtor on the application of the Chapter 13 best interests test. Each of the dissenting creditors in these actions essentially argued that, because their claims were nondischargeable in a Chapter 7 proceeding, they could pursue collection against the debtor post-liquidation for any deficiency; thus, since they would ultimately receive full payment if the debtor went through Chapter 7, the best interest test mandated that the debtor’s Chapter 13 plan pay them in full. See *Ravenot v. Rimgale (In re Rimgale)*, 669 F.2d 426, 430-31 (7th Cir. 1982); *In re Syrus*, 12 B.R. 605, 607 (Bankr. D. Kan. 1981); *In re Hurd*, 4 B.R. 551, 553 (Bankr. W.D. Mich. 1980). The contention was rejected in all of these opinions. In *Rimgale*, the Seventh Circuit explained that, if the argument were valid, Chapter 13’s more generous discharge provisions would be nullified. *In re Rimgale*, 669 F.2d at 431; accord *In re Hurd*, 4 B.R. at 553 (explaining that, under the argument, the Chapter 13 discharge statute “would be . . . meaningless”). (A Chapter 13 discharge is broader than a Chapter 7 discharge. 8 COLLIER ON BANKRUPTCY ¶ 1328.02[2], at 1328-9 (15th ed. rev. 2005); compare 11 U.S.C. § 1328 (2006) with *id.* § 727.) The *Syrus* court relied upon the language of the Chapter 13 statute containing the best interest test, 12 B.R. at 607, which directs the court to compare a claim’s plan distribution to “the amount that would be paid on such claim if the estate of the debtor liquidated under chapter 7,” 11 U.S.C. § 1325(a)(4) (emphasis added). The court explained that most authorities construe the italicized language to refer to “the amount that would actually be distributed out of the assets that were in the estate.” *In re Syrus*, 12 B.R. at 607; see also *In re Hurd*, 4 B.R. at 553 (“Section 1325(a)(4) speaks only to recovery from assets of the debtor’s estate.”). Finally, “nondischargeability does not insure 100% payment . . . [,] only the right to pursue collection of the debt.” *In re Syrus*, 12 B.R. at 607; see also 8 COLLIER ON BANKRUPTCY ¶ 1325.05[2][d] (15th ed. rev. 2008) (“Many such claims are never paid despite the lack of a discharge because debtors remain unable to satisfy them after bankruptcy.”).

Even if the Chapter 13 case law relied upon by the *Dow* bankruptcy court is correct (and there is authority to the contrary, though it is a decided minority), the relationship of nondischargeability to the Chapter 13 best interest test has little bearing here. First, as the *Dow* court concedes, see *In re Dow Corning Corp.*, 237 B.R. at 411, the language of the Chapter 11 best interest test is different from Chapter 13’s. It does not refer to “the amount that would be paid . . . under chapter 7,” 11 U.S.C. § 1325(a)(b) (emphasis added), but rather to “the amount that such holder [of a claim or interest] would receive or retain if the debtor were liquidated,” *id.* § 1129(a)(7) (emphasis added). This is a small, but crucial difference. In a Chapter 7 case, a creditor would “retain” its right to sue co-liable non-debtors for any shortage. Thus, the Chapter 11 best interest test mandates recognition of that right in a plan of reorganization containing a third-party release of the creditor’s claim.

Second, as the *Rimgale* court explained, § 1328 (the Chapter 13 discharge statute) would be nullified if, when performing the Chapter 13 best interests analysis, judges had to consider what a creditor would recover from the debtor post-liquidation on a nondischargeable claim. *In re Rimgale*, 669 F.2d at 431. However, no such problem is created if, while conducting the Chapter 11 best interests analysis, the judge considers what a creditor would obtain from a non-debtor

Few Chapter 11 plans in asbestos cases have complied with the payment-in-full requirement dictated by the best interests test. Rather, in numerous asbestos bankruptcies, the court approved a § 524(g) non-debtor release without mandating that the plan promise complete satisfaction of the extinguished claims. Virtually all § 524(g) litigation trusts operate under a “fixed percentage payout.”<sup>469</sup> Under such an arrangement, asbestos claimants only receive a percentage of the full liquidated value of their tort claims.<sup>470</sup> The precise fraction is typically set in the reorganization plan, but “is subject to change over time

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outside a hypothetical Chapter 7 bankruptcy. No piece of Chapter 11 would be rendered meaningless by following such a procedure.

*Third*, there is a much better analogy to the Chapter 11 best-interests-test/non-debtor-release relationship than the interconnection of the Chapter 13 best interests test and nondischargeable claims: Partnership reorganizations. 11 U.S.C. § 723(a) provides that if the estate of a bankrupt partnership cannot pay all claims in full, the trustee may pursue general partners for any deficiency to the extent permitted under non-bankruptcy law. This statute has led the courts to conclude that the assets that a trustee would recover from *non-debtor* general partners in a Chapter 7 liquidation must be considered when conducting a Chapter 11 best interests analysis. *See, e.g., In re Union Meeting Partners*, 165 B.R. 553, 575 (Bankr. E.D. Pa. 1994) (“Because a bankruptcy court should consider the value of a § 723(a) recovery when calculating the liquidation value needed for the § 1129(a)(7) comparison, . . . a plan proponent should also provide evidence of the net worth of a partnership debtor's general partners.”) (citation omitted); *see also* 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7][c][iv] (15th ed. rev. 2004) (“Under chapter 7 practice, the trustee of a debtor has recourse to the personal assets of the partners of the debtor in order to satisfy partnership debts. Thus, if the chapter 11 debtor is a partnership, the liquidation analysis will also have to estimate the probable collections from general partners of assets which could be paid to creditors.”); FED. R. BANKR. P. 1007(g) (“The court may order any general partner to file a statement of personal assets and liabilities within such time as the court may fix.”). Considering what the trustee would recover from non-debtor general partners is quite similar to considering what creditors would recover from third parties that are co-liable with the debtor. Moreover, if the partners of a debtor-partnership are solvent, the Chapter 11 plan must provide creditors with payment in full. *See In re Grandfather Mountain Ltd. P’ship*, 207 B.R. 475, 484 (Bankr. M.D.N.C. 1996) (explaining that, in light of § 723(a), the best interests test mandated that two unsecured creditors receive payment in full under the partnership-debtor’s Chapter 11 plan of reorganization because it was “undisrupted” that the general partners were solvent); MARK S. SCARBERRY ET AL., BUSINESS REORGANIZATION IN BANKRUPTCY: CASES AND MATERIALS 814 (3d ed. 2006) (because the Chapter 7 trustee of a debtor-partnership with solvent partners may recover sufficient funds from the partners to pay creditors in full under 11 U.S.C. § 723(a) (2006), the best interests test mandates that any such partnership pay creditors in full if it is reorganizing under Chapter 11) (collecting authorities). This supports the proposition that, when a plan releases solvent non-debtors, full payment on the released claims is necessary.

In sum, the crucial assumption of my argument—that the best interests test mandates considering what a creditor would receive from both the debtor *and the non debtor* if a Chapter 11 plan releases claims against the non-debtor—is firmly supported. The *Dow* bankruptcy court is probably correct that non-bankruptcy collections from third parties are *usually* irrelevant in performing the best-interests analysis. But the story changes completely when a plan of reorganization releases claims against such third parties.

<sup>469</sup> Francis E. McGovern, *The Evolution of Asbestos Bankruptcy Trust Distribution Plans*, 62 N.Y.U. ANN. SURV. AM. L. 163, 174 (2006).

<sup>470</sup> *Id.*

under specified circumstances.”<sup>471</sup> By design, these types of plans do not promise payment in full.<sup>472</sup> Yet neither courts nor litigants press best-interests objections against such plans.

Part of the problem may be that it is common for virtually all asbestos claimants to vote in favor of the plan.<sup>473</sup> Consenting claimants do not receive the protection of the best interests test. But in many asbestos insolvencies, even the *dissenting* claimants do not object to confirmation (on any ground at all, let alone under the best interests test).<sup>474</sup> There are many possible explanations for why

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<sup>471</sup> *Id.* at 175.

<sup>472</sup> See, e.g., Joint Plan of Reorganization as of September 25, 2005, as Amended Through January 17, 2006, at Exhibit B at 2, 11, *In re* The Babcock & Wilcox Co., No. 00-10992, 2004 WL 4945985 at \*24-\*28 (Bankr. E.D. La. Nov. 9, 2004) (indicating that the intention of the plan was to pay as close to the full liquidated value as possible, but adopting an initial payment percentage of only thirty-four percent given “the inherent uncertainty” concerning the debtor’s total asbestos liabilities); Fifth Amended Plan of Reorganization, at Exhibit 2 at 3, *In re* United States Mineral Prod., No. 01-2471 (JKF) (Bankr. D. Del. Sep. 27, 2005) (“Because there is uncertainty in the prediction of both the number and severity of future claims, and the amount of the trust’s assets, *no guarantee can be made of any Payment Percentage of a Trust’s Claim’s liquidated value.*” (emphasis added)); *In re* W. Asbestos Co., 313 B.R. 832, 836-37 (Bankr. N.D. Cal. 2003) (explaining that the litigation trust “will process and pay the Class 4 claims *to the extent possible*,” and that the trust will begin by paying 11.5% of the liquidated value of such asbestos claims); Third Amended Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Asbestos Claims Management Corporation (With Technical Modifications), at Appendix A at 5, No. 02-37124-SAF-11 (Bankr. N.D. Tex. Apr. 21, 2003) (“The NGC Bodily Injury Trust will only be able to pay Asbestos Claimants a percentage . . . of the Allowed Liquidated Value . . . of their claims.”); Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for J T Thorpe Company, Exhibit A at 2, *In re* J T Thorpe Co., No. 02-41487-H5-11 (Bankr. S.D. Tex. Oct. 1, 2002) (stating that parties would only be paid a “percentage of the Liquidated Value of each Asbestos Claim . . . to provide reasonable assurance than the Successor Trust will be in a financial position to continue to pay similar Asbestos Claims in substantially the same manner”); see also RAND, *supra* note 2, at 102 (“These plans establish the amount due a claimant—termed the “full liquidated value” of a claim—for each type of claim. However, over time, trusts typically pay lower than liquidated value on current claims in order to preserve funds for paying future claims.”); Plevin et al., *Pre-Packaged Asbestos Bankruptcies*, *supra* note 32, at 912 (noting that asbestos prepacks are often expressly designed not to pay future claims and certain present claims in full).

<sup>473</sup> See, e.g., *In re* Kaiser Aluminum Corp., No. 02-10429(JKF), 7312, 2006 WL 616243, at \*15 (Bankr. D. Del. Feb. 6, 2006) (of the asbestos claimants voting, 99.84% voted in favor of the plan); *In re* J T Thorpe Co., 308 B.R. 782, 787-89 (Bankr. S.D. Tex. 2003) (noting that over ninety-nine percent of the voting members of each class of asbestos claimants voted in favor of the plan), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003), *aff’d*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004); see also Esserman & Parsons, *supra* note 371, at 194 n.33 (“It is common for virtually all claimants voting upon a plan to vote in favor.”).

<sup>474</sup> See Plevin et al., *Where Are They Now*, *supra* note 418, at 9 (“In many § 524(g) cases, a debtor’s insurers are the only objecting parties. As a result, if the debtor can persuade the court that the insurers lack standing, the debtor will be able to proceed with an uncontested confirmation hearing.”); e.g., *In re* W. Asbestos Co., 313 B.R. at 836 (noting that “the only parties objecting to confirmation are four insurance companies”).

virtually no one (if not no one) has objected to § 524(g) third-party releases on best interests grounds. Perhaps litigants are unaware of their legal rights.<sup>475</sup> Or perhaps my argument is not quite as strong as it appears.

## 2. Counterarguments Regarding the Payment-In-Full Requirement

Although few bankruptcy courts have addressed the identity-of-interest element, I suspect subject-matter jurisdiction will often be satisfied with respect to non-debtor claims appropriately enjoined by a § 524(g) supplemental injunction.<sup>476</sup> In addition, most courts carefully apply § 1126(c) in asbestos bankruptcies.<sup>477</sup> My contention that the best interests test mandates full payment on any non-debtor claims barred by a § 524(g) channeling injunction is more controversial.

*The Best Interests Test and the Language of § 524(g).* The most obvious response to my best interests argument is that § 524(g) contains language indicating that partial payment of enjoined asbestos claims is permissible. The statute provides that a supplemental injunction may enjoin a claim or demand that, “under a plan of reorganization, is to be paid in whole *or in part* by” a qualifying litigation trust.<sup>478</sup> Similarly, in setting forth the requirements that need to be satisfied if the injunction bars future claimants from suing the debtor or third parties, the act refers to future demands “to be paid in whole *or in part* by a” litigation trust.<sup>479</sup> Section 524(g) also appears to contemplate less than full payment for asbestos plaintiffs in its requirement that the trust’s operating procedures “provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner.”<sup>480</sup> If payment in full were necessary,

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<sup>475</sup> This may flow in part from the fact that courts assessing the best interests in asbestos cases appear to never consider what the tort claimants would receive from the released third parties in the event the debtor liquidated. *See, e.g., In re Porter Hayden Co.*, No. 02-54152-SD, 2006 WL 4667137, at \*2 (Bankr. D. Md. Jun. 30, 2006) (best-interests finding consists of a single sentence and does not mention the released third parties), *aff’d*, No. 06-201, 2006 WL 4672671 (D. Md. Jul. 7, 2006); *In re Kaiser Aluminum Corp.*, 2006 WL 616243, at \*10 (same); *In re J T Thorpe Co.*, 308 B.R. at 787 (same). In fairness to these courts, and others, the third parties may have been discussed in the liquidation analysis, even though they were not mentioned in the opinions.

<sup>476</sup> Most enjoined non-debtor claims falling within the scope of § 524(g) would probably give rise to the type of indemnity and contribution claims that could “conceivably” impact the estate. *See Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) (holding that bankruptcy courts have jurisdiction over claims that “could conceivably have any effect on the estate being administered in bankruptcy”). Since subject-matter jurisdiction is generally beyond the scope of this article, I do not wish to say more on the topic.

<sup>477</sup> *See supra* note 459 (collecting authorities).

<sup>478</sup> 11 U.S.C. § 524(g)(1)(B) (2006) (emphasis added).

<sup>479</sup> *Id.* § 524(g)(4)(B) (emphasis added).

<sup>480</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(V) (2006).

there would be no need to prescribe comparable treatment for present claims and future demands.<sup>481</sup>

Clearly, if this response is valid, my argument is defeated. But the response fails for three reasons. First, a key aspect of § 524(g) is the enhancement of traditional Code protections. For example, as noted previously, in the standard Chapter 11 case, a plan may be confirmed if either (1) each class of creditors “has accepted” the plan,<sup>482</sup> or (2) the plan complies with the cramdown provisions.<sup>483</sup> A class “accepts” the plan where at least two-thirds in amount and more than one-half in number of the voting claimants cast their ballots in favor of the plan.<sup>484</sup> But § 524(g) demands more: A plan with a supplemental injunction cannot be confirmed under any circumstances unless at least *seventy-five percent* of the voting members of each class of asbestos claimants vote for the plan.<sup>485</sup> Likewise, in other Chapter 11 reorganizations, the requirement that a plan be “fair and equitable” with respect to a given class of creditors only applies when the debtor seeks to confirm the plan via cramdown.<sup>486</sup> Section 524(g), however, mandates that *any* plan enjoining future claims be “fair and equitable” to the persons that hold such rights in light of the benefits provided to the litigation trust by the debtor or any third party protected by the injunction.<sup>487</sup> If § 524(g) non-debtor releases are permissible when the extinguished claims are not paid in full, then the claimants impacted by such a release are entitled to *less* protection than creditors whose third-party rights are discharged under § 105(a) or § 1123(b)(6). This is contrary to § 524(g)’s focus on augmenting Code requirements.

Second, Congress expressly identified the one provision in the Code that § 524(g) supplemental injunctions need not comply with when non-debtors are protected by the injunction. According to the statute, third-party releases are authorized “[n]otwithstanding the provisions of *section 524(e)*.”<sup>488</sup> If Congress had wanted to exempt § 524(g) non-debtor releases from any other Code requirements, it could easily have listed statutes in addition to § 524(e). It did not do so. To the contrary, Congress indicated that the rest of the Code governs supplemental injunctions when it provided that such injunctions are permissible only “in connection with” an order “confirming a plan of reorganization under [C]hapter 11.”<sup>489</sup> And, of course, pursuant to § 1129(a)(7), reorganization plans need to satisfy the best interests test. Consistent with § 524(g)’s straightforward

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<sup>481</sup> Cf. Findlay v. Falise (*In re Joint E. & S. Dist. Asbestos Lit.*), 878 F. Supp. 473, 572 (S.D.N.Y. 1995) (concluding that, because the original Manville plan was supposed to pay all claims in full, there was no need for any “special mechanism of the type described” in § 524(g)(2)(B)(ii)(V)), *aff’d in part, vacated in part*, 78 F.3d 764 (2d Cir. 1996).

<sup>482</sup> 11 U.S.C. §§ 1129(a)(8)(A).

<sup>483</sup> *Id.* § 1129(b)(1).

<sup>484</sup> *Id.* § 1126(c).

<sup>485</sup> *Id.* § 524(g)(2)(B)(ii)(IV)(bb).

<sup>486</sup> *Id.* § 1129(b)(1).

<sup>487</sup> *Id.* § 524(g)(4)(B)(ii).

<sup>488</sup> *Id.* § 524(g)(4)(A)(ii) (emphasis added).

<sup>489</sup> *Id.* § 524(g)(1)(A).

terms, the courts have universally subjected reorganization plans containing channeling injunctions and litigation trusts to all of Chapter 11's provisions.<sup>490</sup>

Third, the language in § 524(g) that arguably permits non-debtor releases without payment in full on the enjoined claims is amenable to alternative and preferable understandings. A supplemental injunction need not shield third parties. The text of the statute plainly authorizes injunctions that protect only the debtor.<sup>491</sup> If the debtor is the sole beneficiary of a channeling injunction, it is quite possible that there will be insufficient funds to pay all asbestos claimants in full since third parties will have no incentive to contribute resources to the trust.<sup>492</sup> The language allowing payment "in part" should be read to permit debtors who are insolvent on a going-concern basis—even with the protection of a channeling injunction—to utilize the trust/injunction mechanism. Indeed, such debtors may be the ones for whom the mechanism will be most beneficial, maximizing the available resources for tort and commercial creditors. Additionally, asbestos plaintiffs frequently sue sixty to seventy defendants for their injuries.<sup>493</sup> Such plaintiffs may receive compensation from multiple alleged tortfeasors. The "in part" language in § 524(g) should thus also be interpreted to allow litigation trusts to make partial payments to plaintiffs who obtain damages from other defendants. Given these alternative constructions, it is completely unnecessary to read the phrase "in part" as undermining claimant protections contained elsewhere in the Code. This is especially true with respect to the protection guaranteed by the best interests test, which is "one of the cornerstones of [C]hapter 11 practice."<sup>494</sup>

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<sup>490</sup> See *supra* note 369 (collecting authorities). Of course, I contend that they have not applied the best interests test correctly.

<sup>491</sup> Compare 11 U.S.C. § 524(g)(4)(A)(ii) (stating that a supplemental "injunction *may* bar any action directed against a third party" (emphasis added)), with *id.* § 524(g)(3)(A)(ii) (providing that *no* successor who receives property from the debtor or the litigation trust pursuant to the plan or thereafter "*shall* be liable with respect to any claim" (emphasis added)).

<sup>492</sup> See *supra* notes 469-72 and accompanying text (noting that few plans of reorganization in asbestos bankruptcies promise payment in full to the tort claimants); *infra* notes 545-51 and accompanying text (noting that many asbestos debtors defaulted on the plans of reorganization, paying less than was promised under the plan).

<sup>493</sup> Brickman, *supra* note 24, at 992.

<sup>494</sup> 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7], at 1129-45 (Lawrence P. King ed., 15th ed. rev. 2004); accord *In re Sierra-Cal*, 210 B.R. 168, 172 (Bankr. E.D. Ca. 1997).

Another textual provision someone objecting to my argument could raise is § 524(g)(2)(B)(ii)(II), which provides that a debtor may not utilize § 524(g) unless the amount of its future asbestos obligations cannot be determined. If such amounts cannot be determined, one might ask, how can a plan of reorganization assure payment in full to asbestos claimants? This is a pretty thin basis for any contention that the best interests test no longer requires payment in full on claims barred by a non-debtor release in asbestos cases. And it is clearly subject to my first two replies in the text. I think it is also subject to a version of the third reply: The language is amenable to an alternative interpretation. Just because the debtor's future liabilities "cannot be determined," does not mean that the debtor and other parties are entirely in the dark. If they were, the court would be unable to assess the feasibility of the plan under 11 U.S.C. § 1129(a)(11) (2006); it would be impossible to determine whether the debtor could satisfy its plan obligations (even with the

*Does the Best Interests Test Always Require Payment in Full?* Another response to my argument is that the best interests test does not always require payment in full on claims extinguished by a third-party release, whether the release is issued under § 105(a) or § 524(g). Suppose a group of asbestos plaintiffs holds claims of questionable validity against the third parties shielded by a supplemental injunction. In a Chapter 7 liquidation, the plaintiffs would receive only pro rata payments from the insolvent debtor and likely nothing from the third parties.<sup>495</sup> Or suppose that the debtor's Chapter 7 filing, combined with the crush of tort claims, would put pressure on the third parties to file for bankruptcy themselves. Perhaps both the debtor and the non-debtors scheduled for protection under the injunction are insolvent when the debtor's asbestos liabilities are taken into account. Under either the "weak-third-party-claims" scenario or the "insolvent-non-debtor" scenario, the bankruptcy court may conclude that the tort claimants would *not* receive payment in full if the debtor proceeded with a Chapter 7 bankruptcy, and thus the Chapter 11 plan need not completely satisfy the released claims despite the best interests test.

It is first necessary to point out the limited nature of this counterargument. The two hypothetical scenarios raise an issue about the applicability of the full-payment requirement *only* when the debtor's liquidation analysis demonstrates (1) that the non-debtor claims are genuinely questionable, or (2) that the released third parties are truly insolvent.<sup>496</sup> Either point will be established in merely a subset of asbestos (or other) bankruptcies involving non-debtor releases. The claims against the third parties will often be meritorious. And those persons will frequently be solvent.<sup>497</sup>

Nonetheless, this response has merit. In assessing whether a plan meets the best interests test, courts consider the solvency of non-debtors in certain circumstances—most importantly, in the partnership context, where they must assess the financial status of general partners of a debtor-partnership.<sup>498</sup> If the

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flexibility written into many asbestos-related plans of reorganization). If non-debtors are going to be shielded by a § 524(g) third-party release, they should not be able to hide behind any uncertainty regarding the debtor's liabilities in order to avoid the full application of the best interests test. And § 524(g)(2)(B)(ii)(II) ultimately does not contain any language that suggests otherwise.

<sup>495</sup> See Feldstein, *supra* note 465, at 43 ("Accordingly, if the claims released under the plan *have any real value*, then the best interest test requires realization of that value for the plan to be confirmed." (emphasis added)); *cf.* Esserman & Parsons, *supra* note 371, at 208 (suggesting that asbestos claimants will frequently be better off if the debtor reorganizes because third parties shielded by a § 524(g) supplemental injunction are certain to make financial contributions; if the debtor liquidates the asbestos claimants will have to conduct "speculative and costly litigation" in order to recover from the third parties).

<sup>496</sup> For a short discussion of liquidation analysis, see *supra* note 463.

<sup>497</sup> See, e.g., *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 237, 238 n. 51 (3d Cir. 2004) (stating that there was no evidence that two affiliates of the debtor, who were seeking the protection of a non-debtor release, needed to reorganize; noting, in particular, that one of non-debtors was clearly solvent).

<sup>498</sup> See 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7][c][iv] (15th ed. rev. 2004) ("Under [C]hapter 7 practice, the trustee of a debtor has recourse to the personal assets of the partners of the debtor in order to satisfy partnership debts. Thus, if the [C]hapter 11 debtor is a partnership, the liquidation

partners are solvent, a Chapter 7 trustee is entitled to pursue the partners for any deficiency,<sup>499</sup> and the Chapter 11 plan must therefore pay the partnership's creditors in full.<sup>500</sup> Where the partners are insolvent, however, the best interests test arguably no longer requires complete satisfaction of creditor claims. Likewise, courts sometimes assess the validity of claims in performing best interests analysis.<sup>501</sup> For example, one court held that, although the best interests analysis requires taking into account that the trustee would seek disallowance of certain claims under § 502(d),<sup>502</sup> it is not necessary to adjudicate a § 502(d) objection<sup>503</sup> or reach a definitive conclusion as to whether the trustee would be successful. Rather, because the court considers only a hypothetical Chapter 7 liquidation in performing best interests analysis, it is entitled to "speculate" about the likely outcome of the adjudication.<sup>504</sup>

On the validity question, there is authority to the contrary. Some courts have ruled that it is inappropriate to consider the legitimacy of claims in the best interests context because it is impractical to estimate the prospects of collectability.<sup>505</sup> But all this indicates is that the issue is an open one.

My intention here is not to resolve what courts should consider when conducting the best interests analysis *in bankruptcies generally*. I am willing to assume that, if the circumstances so warrant, it *is* often appropriate to consider the solvency of non-debtors (e.g., of general partners) and the legitimacy of claims and objections (e.g., § 502(d) disallowance) when applying the best

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analysis will also have to estimate the probable collections from general partners of assets which could be paid to creditors." For a thorough discussion of this point, see *supra* note 468.

<sup>499</sup> 11 U.S.C. § 723(a) (2006).

<sup>500</sup> SCARBERRY ET AL., *supra* note 468, at 814 (noting that because the Chapter 7 trustee of a debtor-partnership with solvent partners may recover sufficient funds from the partners to pay creditors in full under 11 U.S.C. § 723(a) (2006), the best interests test mandates that any such partnership pay creditors in full if it is reorganizing under Chapter 11) (collecting authorities). For more on this topic, see *supra* note 468.

<sup>501</sup> See *In re Sierra-Cal*, 210 B.R. 168, 172 (Bankr. E.D. Cal. 1997) (stating that the best interests test "requires estimation of disputed and contingent claims and of [C]hapter 7 administrative expenses.").

<sup>502</sup> *Id.* at 174; see also 11 U.S.C. § 502(d) (2006) (providing for the mandatory disallowance of claims filed by creditors holding property recoverable under various avoidance statutes).

<sup>503</sup> *In re Sierra-Cal*, 210 B.R. at 174 ("The 'best interests' analysis in plan confirmation being hypothetical, it is not necessary (as would be required in an actual liquidation) to adjudicate the creditor's § 502(d) status before imposing the § 502(d) disability.").

<sup>504</sup> *Id.* at 174 ("In computing the hypothetical [C]hapter 7 liquidation, the court is entitled to view the entire record of the case and to engage in rational speculation about what would occur in a [C]hapter 7 liquidation. Among other things, the court can hypothesize that certain claims would evoke the objection of a [C]hapter 7 trustee and can speculate about the likely fate of such objections, bearing in mind the protective purpose of the 'best interests' test.").

<sup>505</sup> See, e.g., *In re Syrus*, 12 B.R. 605, 607 (Bankr. D. Kan. 1981) ("The extent of collectability and the offsetting costs of collection cannot be estimated by the courts."); *In re Hurd*, 4 B.R. 551, 553 (Bankr. W.D. Mich. 1980) ("It would also be impractical for the court to place a value on a creditor's right of action against a debtor not discharged; factors such as the speed with which judgment could be obtained, and collectability of the judgment, would have to be considered. Yet, how could the Court fairly and accurately consider these factors?").

interests test. I want to proffer a more narrow argument, applicable only to a limited number of cases: Assessing non-debtor solvency or the legitimacy of claims against the non-debtor for best interests purposes is inappropriate when such assessment *is a prelude to a non-debtor release*.

If a co-obligor of the debtor is genuinely insolvent, it should commence its own bankruptcy (or perhaps jointly file with the debtor). A release of liability is one of the signature benefits offered by the Code. To achieve this coveted relief, a party almost always has to submit to the full jurisdiction of the bankruptcy court. As explained by judges and commentators alike, it is such submission, combined with the party's insolvency, that justifies the bankruptcy court's extraordinary power to compel creditors to accept partial recovery.<sup>506</sup> Sections 105(a) and 524(g) create narrow exceptions to these principles, permitting the court to extinguish the liabilities of non-debtors who have not directly invoked the bankruptcy system. Where the non-debtor proffers sufficient assets to enable the plan to promise payment in full to asbestos claimants, there is no great danger in protecting the non-debtor via a release. But when the non-debtor contributes insufficient funding for complete resolution of the debtor's asbestos obligations because the non-debtor is purportedly insolvent—yet still receives the benefit of a release—the absolved third party escapes its tort liability without ever having to accede to the bankruptcy process. If the non-debtor desires the type of relief generally reserved for debtors—if the non-debtor is seeking an *actual* release, a release of claims that will *not* be paid in full—it should submit fully to the bankruptcy court's jurisdiction. Only then can a proper assessment of the third party's financial status take place. Review of a liquidation analysis is too narrow a proceeding.

Admittedly, my argument does not find support in the explicit language of § 1129(a)(7) or elsewhere of the Code. And we must be mindful of the Supreme Court's admonishment to employ a plain meaning approach to the interpretation of federal statutes,<sup>507</sup> an approach the court has regularly followed with respect to the Bankruptcy Code.<sup>508</sup> But third-party releases issued outside the asbestos context, and a significant number of releases in asbestos cases, are granted pursuant to § 105(a) and § 1123(b)(6). Those statutes, as the primary sources of the bankruptcy court's general equitable powers,<sup>509</sup> are obviously concerned with

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<sup>506</sup> See *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 506 (Bankr. D.N.J. 1997) (quoting Judith R. Starr, *Bankruptcy Court Jurisdiction to Release Insiders from Creditor Claims in Corporate Reorganizations*, 9 BANKR. DEV. J. 485, 498 (1993)).

<sup>507</sup> See *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (“[W]hen the statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.” (internal quotation marks omitted) (quoting *United States v. Ron Pair Enters., Inc.* 489 U.S. 235, 241(1989))).

<sup>508</sup> See, e.g., *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) (“It is well established that ‘when the statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.’” (quoting *Hartford Underwriters*, 530 U.S. at 6; construing various provisions of the Bankruptcy Code)).

<sup>509</sup> See *supra* note 191 and accompanying text.

*equity*. And thus, it is appropriate for courts to give weight to broader bankruptcy policies and structural considerations, like those articulated in the previous paragraph, in deciding whether to grant a non-debtor release. In fact, in my prior article, I expressly argued that, even when the *Master Mortgage* test (or my modified version) is satisfied, a court is not *required* to confer a release; it merely has the *authority* to do so. After finding that the *Master Mortgage* elements are met, the court must still exercise its *discretion* and consider the equities in determining whether such a dramatic remedy is truly warranted in the case before it.<sup>510</sup> Note that I am not asserting that courts are statutorily prohibited from considering a non-debtor's insolvency in deciding whether an *actual* release—as opposed to a channeling release—satisfies the best interests test.<sup>511</sup> Rather, I am contending that the court should, in the exercise of its discretion, always (or almost always) refuse to grant actual releases on *equitable* grounds where the purported justification for ignoring the last element of the *Master Mortgage* test is that the proposed beneficiaries of the release are insolvent. If they are indeed insolvent, the prospective releasees should be denied relief unless they declare bankruptcy themselves.<sup>512</sup>

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<sup>510</sup> Silverstein, *supra* note 6, at 79-80 & n.358 (collecting authorities).

<sup>511</sup> For readers familiar with my past article, this is what distinguishes my point *here* from one of the anti-release arguments I rejected with respect to § 524(e) in the prior piece. To recap, perhaps because § 524(e) does not expressly forbid releases, some anti-release authorities have relied upon the policies underlying that provision, and underlying the Bankruptcy Code generally, in arguing that § 524(e) bars third-party releases. Silverstein, *supra* note 6, at 49-50, 122, 125. I criticized such reasoning in light of the Supreme Court's plain-meaning approach to statutory interpretation as exemplified in *United States v. Energy Resource Co.*, 495 U.S. 545 (1990). Silverstein, *supra* note 6, at 123-28. The anti-release authorities used broad structural reasoning and underlying-policy arguments to assert that § 524(e) is a *statutory bar* on *all* non-debtor releases, an interpretation that goes beyond the statute's plain terms. This is exactly the type of statutory construction the Supreme Court has disavowed. *Id.* at 123-26. And thus, I still believe the anti-release authorities are incorrect for the reasons I articulated in my last article. In the current piece, I *am* relying on the same structural and policy arguments proffered by the anti-release authorities. But I am doing so in a very different context: I am using the anti-release arguments as a basis for recommending, *on wholly equitable grounds*, that courts refuse to grant § 105(a) and § 1123(b)(6) *actual* releases (as opposed to *channeling* releases) where the asserted justification for not paying the creditors in full is the alleged insolvency of the shielded non-debtor. I am *not* using structural and policy reasoning to twist a statute like § 524(e) in a direction it will not go. And the High Court's jurisprudence on statutory interpretation contains nothing that conflicts with my contention that, when exercising *equitable* powers, courts should consider broader arguments based on structure and underlying policies.

<sup>512</sup> *Cf. In re Combustion Eng'g, Inc.* 391 F.3d 190, 237 (3d Cir. 2004) (noting that “the practical effect” of two proposed § 105(a) non-debtor releases “is to extend bankruptcy relief to two non-debtor companies outside of bankruptcy”) (further observing that the releases allow the non-debtors “to cleanse themselves of non-derivative asbestos liability without enduring the rigors of bankruptcy”); Brubaker, *supra* note 173, at 994 (observing that “non-debtor releases interject discharge of creditors’ non-debtor rights into a bankruptcy process designed to restructure only creditor claims against the debtor”).

The same reasoning applies with respect to the validity of non-debtor claims that a plan proposes to extinguish. In exercising its equitable discretion, a court should be very hesitant to permanently enjoin the prosecution of such a claim because it believes the cause of action is baseless, and thus would not be paid if the debtor liquidated under Chapter 7. Creditors holding claims against non-debtors are generally entitled, on *equitable* grounds, to either a promise of payment in full in the plan of reorganization, *or* a full adjudication on the merits. Moreover, if the claims against the third-party really are so weak, the third-party ought to be able to settle with the creditors for a modest amount,<sup>513</sup> converting the requested relief from an equitably problematic involuntary release into a wholly legitimate *voluntary* one.

Of course, this analysis is pertinent only to releases granted under §§ 105(a) and 1123(b)(6). Section 524(g) is not a general equitable statute like the other two provisions. Thus, there is substantially less basis to argue for equitable limits on supplemental injunctions in asbestos cases—such as my proposed restrictions on the scope of liquidation analyses conducted pursuant to the best interests test when a non-debtor release is involved. Accordingly, for § 524(g) third-party releases, the validity of the claims against the non-debtor and that party's solvency are likely appropriate questions to consider in addressing whether the best interests test mandates payment in full on the released claims. And if the court ultimately concludes that either the non-debtor is insolvent or the claims against it lack merit, the court *may* uphold the § 524(g) non-debtor release even though the plan of reorganization does not promise the asbestos claimants full payment on the extinguished rights.<sup>514</sup>

There is one more context in which the best interests test *might* not mandate payment in full for claims enjoined by a § 524(g) third-party release. Recall the discussion in Part IV.B regarding *insurance* non-debtor releases issued outside the asbestos context. There, I presented the following argument. Assume a debtor and its insurer settle a coverage dispute for *less* than the policy limits. Assume further that, in conjunction with the settlement, the court issues a third-party release extinguishing all claims against the carrier relating to the compromised policy, including claims held by additional insureds and tort claimants with property interests in the policy. An insurance release of this type *might* be permissible under § 363(f) in *Chapter 7* bankruptcies. If such releases *are* authorized in Chapter 7 cases, then additional insureds and tort claimants will not necessarily receive payment in full if the debtor liquidates. And, if these

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<sup>513</sup> Cf. Brubaker, *supra* note 173, at 993 n.122 (“The risk averse non-debtor would be willing to trade a greater certain contribution in exchange for release from a lower projected, but uncertain, liability outside bankruptcy.”).

<sup>514</sup> In an essay on § 524(g), Katherine Porter offered the following: “The controversy that courts must resolve is whether [asbestos] claimants would receive more if solvent nondebtors either had to pay claimants out of their own (often sizeable) profits or had to file separate bankruptcy cases that put all of the nondebtor company’s value at issue in negotiating the terms of a trust.” Porter, *supra* note 30, at 229-30. I am uncertain as to the precise point Ms. Porter is pressing in this quotation, but it seemed sufficiently related to my discussion of the best interests test and non-debtor solvency that I wanted to present it.

creditors will not receive full payment in a hypothetical Chapter 7 proceeding, the best interests test does not require full payment on the released claims in the debtor's Chapter 11 action. Accordingly, *outside* the asbestos context, when an *insurance* non-debtor release is included in a plan of reorganization that does not promise the additional insureds and tort claimants payment in full on the extinguished claims, the best interests test does not invalidate the release.

If this argument is valid, then insurance third-party releases issued under § 524(g) in asbestos cases would also not be subject to the payment-in-full requirement. My contention—that the best interests test mandates full payment on the non-debtor claims enjoined by a supplemental injunction—is premised on the inability of courts to issue such an injunction (or any other type of third-party release) in Chapter 7 cases. After all, § 524(g) applies solely in Chapter 11 proceedings. And non-debtor releases granted under § 105(a) or § 1123(b)(6) are legal, at most, only when necessary to a debtor's *reorganization*. But if § 363(f) authorizes *insurance* third-party releases in *Chapter 7 liquidations*, then the premise of my position is false with respect to insurance releases. This would mean that there is one type of § 524(g) non-debtor release that *is* conferrable without any promise of payment in full on the barred claims: a supplemental injunction shielding an insurance company under § 524(g)(4)(A)(ii)(III). According to this argument, since insurance releases are allowed in Chapter 7 under § 363(f), asbestos claimants will not always recover in full from the carriers if the debtor liquidates. And thus, a § 524(g) insurance release may sometimes be included in Chapter 11 plans that do not promise the tort plaintiffs full payment on the enjoined claims.

As I have implied at various points throughout this Article, I am undecided on the question of whether § 363(f) permits courts to grant insurance releases in Chapter 7 bankruptcies. To answer this question, I would need to resolve the complex issues discussed in Part IV.B, including the four-way split in the courts concerning whether (and to what extent) liability insurance proceeds are property of the estate. That task is beyond the scope of this Article. But I felt it essential to bring to the reader's attention the legal morass related to insurance non-debtor releases; in my experience, § 524(g) insurance releases are sought by plan proponents (and granted by the courts) in *all* asbestos bankruptcies. Judges and lawyers thus need to be aware of the complexities inherent in this type of release. And since the authorities are split on a number of the issues that impact the propriety of Chapter 7 insurance releases, those same judges and lawyers must also be mindful of the local governing precedents. For example, in jurisdictions where *none* of the proceeds of the debtor's liability insurance are part of the debtor's estate, § 363(f) *almost certainly* may not be used to grant an insurance release, in Chapter 7 or otherwise. And thus any § 524(g) insurance release must be contained in a plan that provides payment in full on the enjoined claims. In territories where the *debtor's share* of the proceeds is part of the estate, § 363(f) *probably* may not be used to confer an insurance release—leading to the same result under § 524(g) as in the first group of jurisdictions. Finally, in circuits where *all* of the proceeds are estate property, there is a strong case that § 363(f)

does justify at least some Chapter 7 insurance non-debtor releases.<sup>515</sup> And therefore § 524(g) insurance releases need *not* be contained in reorganization plans that provide full payment on the barred claims.

*The Best Interests Test and Future Claimants.* A final response to my best interests argument proceeds as follows. Even if the best interests test does require payment in full on any claims extinguished by a § 524(g) release, this protection does not accrue to *future* claimants. Section 1129(a)(7)(A) only applies to persons who hold “a claim or interest.”<sup>516</sup> And future claimants do not hold bankruptcy “claims.” They merely possess what § 524(g) describes as a “demand.”<sup>517</sup>

This argument, even if valid, is of little import. Section 524(g) requires that the holders of present and future claims receive substantially equivalent treatment under the plan of reorganization. The statute mandates that the trust’s operating procedures “provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims *in substantially the same manner.*”<sup>518</sup> This language prohibits significant discrimination between present and future asbestos claimants.<sup>519</sup> If present tort plaintiffs are entitled to payment in full, future tort plaintiffs must receive “substantially the same” protection. We can thus leave aside the issue of whether future claimants hold bankruptcy “claims” or not.<sup>520</sup> Because these creditors are entitled to treatment comparable to present claimants, they must effectively receive the protections guaranteed by the best interests test.

To summarize my position so far, if an asbestos non-debtor release is issued pursuant to § 105(a) or § 1123(b)(6), then general release law applies, including the requirement of payment in full on the extinguished claims.<sup>521</sup> If an asbestos release is validly issued under § 524(g), then full payment is necessary, except in three circumstances: (1) where the released non-debtor is insolvent; (2) where the claims against the non-debtor are speculative; and (3) *perhaps* where the non-debtor is an insurance company and the supplemental injunction bars claims against it related to insurance policies that have since been compromised. As the case law currently stands, it is unclear whether payment in full is required in the third circumstance; the answer to the question likely varies with the circuit, and I am taking no firm position here.

<sup>515</sup> I used the locution “strong case” because there are also issues specific to § 363(f), rather than to the property-of-the-estate question, that must be resolved. See *supra* note 343.

<sup>516</sup> 11 U.S.C. § 1129(a)(7)(A) (2006).

<sup>517</sup> See *id.* § 524(g)(5). Moreover, if the debtor liquidated, it is likely that future claimants would receive *no money at all*, at least from the debtor. Plevin et al., *Future Claims Representative*, *supra* note 32, at 276 (arguing that liquidation provides “some recourse for current claimants,” but “it would leave *future* claimants entirely without recourse”).

<sup>518</sup> 11 U.S.C. § 524(g)(2)(B)(ii)(V) (2006) (emphasis added).

<sup>519</sup> See *In re ACandS, Inc.*, 311 B.R. 36, 42 (Bankr. D. Del. 2004) (finding that plan violated § 524(g)(2)(B)(ii)(V) because of excessive discrimination between claims).

<sup>520</sup> For a brief discussion of this issue, see *supra* notes 92-93 and accompanying text.

<sup>521</sup> Of course, in anti-release jurisdictions, courts and litigants must take account of governing precedents that are contrary to my view.

### 3. Asbestos Non-Debtor Releases and the Fair-and-Equitable Standard

There is one issue left to discuss regarding third-party releases issued pursuant to § 524(g). The statute provides that enjoining *future* claimants from suing the debtor and/or third parties must be “fair and equitable” to such claimants “in light of the benefits provided” to the trust “on behalf of” the debtor and any protected third parties.<sup>522</sup> What does the phrase “fair and equitable” mean? I have saved this issue for last because, in my view, the “fair and equitable” language of § 524(g) should be construed in light of the payment-in-full requirement mandated by the best interests test.

When applying the “fair and equitable” requirement, most courts perform a generalized “fairness” analysis.<sup>523</sup> This analysis is typically cursory in nature, comprising just a few sentences in the opinion confirming the plan of reorganization. The court notes simply that the contributions provided by the protected debtor and third parties make the channeling injunction “fair and equitable.”<sup>524</sup>

Beyond § 524(g), the only other Bankruptcy Code provisions that use the phrase “fair and equitable” are the cramdown provisions. Under § 1129(b)(1), a reorganization plan may be confirmed over the objection of a dissenting class only if the plan “is fair and equitable” with respect to the class.<sup>525</sup> In the cramdown context, the concept of “fair and equitable” has multiple components,<sup>526</sup> including both codified and uncodified elements.<sup>527</sup> One of the

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<sup>522</sup> 11 U.S.C. § 524(g)(4)(B)(ii).

<sup>523</sup> *In re Congoleum Corp.*, 362 B.R. 167, 179 (Bankr. D.N.J. 2007) (“Most courts that have looked at the fair and equitable requirement for the injunction in 11 U.S.C. § 524(g)(4)(B)(ii) have looked at all the elements of a plan and then made a generalized determination of what is fair and equitable.”).

<sup>524</sup> *See, e.g., In re Kaiser Aluminum Corp.*, No. 02-10429(JKF), 7312, 2006 WL 616243, at \*16-\*17 (Bankr. D. Del. Feb. 6, 2006) (noting the various contributions, and summarily concluding in one sentence that the plan was fair and equitable to future claimants), *aff’d*, 343 B.R. 88 (D. Del. 2006); *In re J T Thorpe Co.*, 308 B.R. 782, 790-91 (Bankr. S.D. Tex. 2003) (listing the parent company’s contributions on behalf of itself and certain other released third parties, and then concluding with a one-sentence finding that extending the injunction to cover the parent and the other third parties was fair and equitable with respect to future claimants), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003), *aff’d*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004). *But see In re ABB Lummus Global, Inc.*, No. 06-10401-JKF, 2006 WL 2052409, at \*18-\*20 (Bankr. D. Del. Jun. 29, 2006) (finding the non-debtor release to be fair and equitable to future claimants because the contributions by the non-debtors were sufficient to enable all asbestos claimants to receive payment in full).

<sup>525</sup> 11 U.S.C. § 1129(b)(1) (2006); *see also id.* § 1129(b)(2) (identifying several requirements included under the concept of “fair and equitable”); *id.* § 943 (providing that a municipality reorganization plan must comply with the sections identified in § 901); *id.* § 901 (identifying §§ 1129(b)(1), 1129(b)(2)(A) & 1129(b)(2)(B)). It should be noted that two other sections of the Code use the similar locution “fairly and equitably.” *See* 11 U.S.C. §§ 1113(b)(1)(A), 1114(f)(1)(A), 1114(g)(3).

<sup>526</sup> *See generally* 7 COLLIER ON BANKRUPTCY ¶¶ 1129.04[4], 1129.05 (15th ed. rev. 2004 & 2005).

most crucial is the absolute priority rule,<sup>528</sup> which is codified in § 1129(b)(2).<sup>529</sup> Another, uncodified piece adopted by many courts is a prohibition on the “unfair and unreasonable shifting of [the] risk” of plan failure from junior to senior classes.<sup>530</sup>

At least one court has expressly concluded that the phrase “fair and equitable” has a different meaning in § 524(g) than it does in § 1129(b).<sup>531</sup> And the analysis of the § 524(g) requirement performed by other courts implies the same understanding.<sup>532</sup> But there is a strong argument that the phrase has substantially the same meaning in both statutes.

When Congress drafted the cramdown provisions, it chose the phrase “fair and equitable” with care.<sup>533</sup> These words “reflect and stand proxy for almost a century of judicial decision-making, and over a century of legislative guidance.”<sup>534</sup> And when Congress decided to use the term “fair and equitable” a second time, in § 524(g), it is reasonable to presume that the legislative body acted with the same circumspection.<sup>535</sup>

If the traditional understanding of “fair and equitable” applies to channeling injunctions that bar future claimants from prosecuting their rights against the debtor or third parties, the impact would be significant. For example, the absolute priority component would mandate that, where the channeling injunction shields the debtor from future claims, the plan must promise the future claimants payment in full, or the debtor’s shareholders have to lose their equity.<sup>536</sup> True, other provisions of § 524(g) only require that the litigation trust

<sup>527</sup> *Id.* ¶ 1129.05 (identifying and discussing the codified pieces); *id.* ¶ 1129.04[4][b] (15th ed. rev. 2004) (identifying and discussing the uncodified pieces); *id.* ¶ 1129.04[4][c] (discussing one particular uncodified piece—the new value component). Some of the uncodified “fair and equitable” components are more well established than others. *Id.* ¶ 1129.04[4], at 1129-90.

<sup>528</sup> *Id.* ¶ 1129.04[4][a], at 1129-90.

<sup>529</sup> *See* 11 U.S.C. § 1129(b)(2).

<sup>530</sup> 7 COLLIER ¶ 1129.04[4][b][ii], at 1129-107.

<sup>531</sup> *See In re W. Asbestos Co.*, 313 B.R. 832, 850 n. 25 (Bankr. N.D. Cal. 2003).

<sup>532</sup> *See supra* notes 523-24 and accompanying text.

<sup>533</sup> 7 COLLIER ¶ 1129.04[4], at 1129-89.

<sup>534</sup> *Id.* ¶ 1129.04[4], at 1129-90.

<sup>535</sup> Moreover, in the cramdown context, the fair-and-equitable standard, including the absolute priority rule, only applies to dissenting classes of creditors. *See* 11 U.S.C. § 1129(b)(1) (2006). But future claimants are incapable of accepting or rejecting the plan because they are not direct participants in the reorganization process. *See id.* § 524(g)(5)(A). They are involved only through the future claims representative, *see id.* § 524(g)(4)(B)(i), who arguably does not get to vote on the plan, *see supra* notes 385-86 and accompanying text. Since future claimants are not in a position to dissent from a plan that sacrifices their interests to other plan constituencies, alternative forms of protection are necessary. Congress may reasonably have concluded that requiring that the plan *always* treat future claimants in a fair and equitable manner is one such protection. (Another is the provision mandating that present and future asbestos claimants receive substantially similar treatment contained in § 524(g)(2)(B)(ii)(V).) In short, there are good reasons to believe that § 524(g) uses the phrase “fair and equitable” in the traditional sense. However, as will be made clear in the text shortly, I ultimately find this conclusion unpersuasive.

<sup>536</sup> 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][a], at 1129-92 (15th ed. rev. 2004) (explaining the absolute priority rule).

(1) “be funded . . . by the securities of [one] or more debtors”<sup>537</sup> and (2) receive immediate or contingent ownership of “a majority of the voting shares” of the debtor.<sup>538</sup> But these obligations (and the other provisions of § 524(g)) are best understood, I contend, as setting merely the *minimum* requirements for the architecture of the litigation trust. They do not negate requirements implicit in other Code sections that mandate higher standards in terms of the trust’s structure. On this interpretation of § 524(g), if a supplemental injunction enjoins future claims that the trust will not be paying in full, the original equity holders must lose their ownership interests.<sup>539</sup>

There is an important response to this argument. The phrase “fair and equitable” is used differently in §§ 524(g) and 1129(b)(1). In the latter provision, the phrase is unqualified: A plan must be “fair and equitable . . . with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”<sup>540</sup> In the former, the term is used in conjunction with other language: The court must determine that shielding the debtor or third parties “is fair and equitable . . . *in light of the benefits provided*” to the trust on behalf of the debtor or third parties.<sup>541</sup> This contrast suggests that the words have a different meaning in § 524(g), a meaning that centers on the contributions being made by the shielded parties, rather than absolute priority or other traditional fair-and-equitable principles.<sup>542</sup> Given the alternative context, I find this second interpretation to be more persuasive. “Fair and equitable” has a distinct meaning in § 524(g), one that is not rigidly tied to the understanding applicable to those same words as set forth in the cramdown statute.

However, even though the words “fair and equitable” connote something different in § 524(g), this does not entail that their meaning is wholly variant from the identical language in § 1129(b)(1). One piece of the cramdown understanding of “fair and equitable” is that the plan must not unreasonably shift the risk of plan failure from junior to senior creditors.<sup>543</sup> A similar notion of risk shifting should be read into § 524(g)’s usage of the phrase, particularly as applied to non-debtors protected by the supplemental injunction.

Section 524(g)’s “fair and equitable” requirement commands the court to determine whether it is appropriate to protect the debtor and non-debtors from

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<sup>537</sup> 11 U.S.C. § 524(g)(2)(B)(i)(II) (2006).

<sup>538</sup> *Id.* § 524(g)(2)(B)(i)(III) (also stating that this requirement can be satisfied through ownership of the debtor’s parent or subsidiaries).

<sup>539</sup> My argument here does not entail that the trust own 100% of the reorganized debtor immediately upon the latter’s emergence from Chapter 11. The trust might share ownership with other creditors, such as commercial claimants.

<sup>540</sup> 11 U.S.C. § 1129(b)(1).

<sup>541</sup> *Id.* § 524(g)(4)(B)(ii) (emphasis added).

<sup>542</sup> *Cf.* 6 COLLIER ON BANKRUPTCY ¶¶ 943.03[1][f] & 943.03[1][f][i][A], at 943-14 to 943-15 (15th ed. rev. 2000) (explaining that, while the Chapter 11 cramdown provisions govern in Chapter 9 municipality reorganizations, “the strict fair and equitable rule of corporation reorganizations cannot be applied without some adjustments,” and identifying some of the adjustments that are necessary).

<sup>543</sup> *See supra* note 530 and accompanying text.

future claims—restricting future claimants to recovery from the litigation trust—given the level of funding the protected parties are contributing to the trust.<sup>544</sup> The primary concern with respect to future claimants is that the trust will run out of money years after confirmation, either because more future claimants appear than anticipated or because the debtor runs into business difficulties and is unable to fulfill its obligations to the trust.<sup>545</sup> This is not an insignificant concern.

In a recent article, James Stengel compiled a chart detailing the payments being made by nineteen asbestos litigation trusts as of 2006.<sup>546</sup> The data present a bleak picture, to say the least. Of the nineteen trusts, eleven were not making any payments at all to claimants at that time, though a few were scheduled to start doing so. Four others were paying a *de minimis* amount—for example, one was paying twenty-five dollars and another was paying 0.6% of a claim's value. One trust was making payments only to plaintiffs suffering malignant injuries. And the other three were paying at 5%, 11.25%, and 15% of a tort claim's value.<sup>547</sup> Not one of these trusts was paying even twenty-five cents on the dollar, let alone full compensation. Stengel added that “all trusts pay only a fraction of claim value, most have reduced payments (often dramatically), and several have failed.”<sup>548</sup> Other commentators have similarly documented the litigation trusts' payment problems.<sup>549</sup> For example, *Asbestos Litigation*, a report by the RAND Corporation, notes that many trusts “pay only pennies on the dollar,”<sup>550</sup> and offers the following conclusion: “It is certain that many of the asbestos personal injury trusts established as a result of Chapter 11 bankruptcy reorganizations pay only a small fraction of the agreed-upon value of plaintiffs' claims; there is no reason to believe that the reorganizations currently in process will yield vastly different outcomes.”<sup>551</sup>

Some commentators contend that the fair-and-equitable requirement has induced third parties to make substantial contributions to litigation trusts.<sup>552</sup> And

<sup>544</sup> 11 U.S.C. § 524(g)(4)(B)(ii).

<sup>545</sup> See RAND, *supra* note 2, at 105 (“The history of asbestos litigation has been characterized by failures to forecast its magnitude, scope, and evolution with any accuracy.”); see also *id.* at 102 (“The trusts are required to provide for future claimants and, consequently, the trusts are generally concerned about being sure there will be money for future claimants.”) (further explaining that to preserve funds for future claimants, trusts “typically pay lower than liquidated value on current claims”).

<sup>546</sup> Stengel, *supra* note 29, at 262. Some of the trusts on the list, such as the Manville trust, predate § 524(g).

<sup>547</sup> *Id.*

<sup>548</sup> *Id.* at 263 (emphasis added); *id.* at 262 (concluding that the asbestos litigation trusts “have been a dismal failure”).

<sup>549</sup> See, e.g., *id.*, at 261 (“According to David Austern, the general counsel of the Manville Trust: ‘No existing asbestos trust, except for Manville, has ever paid full liquidated value to any claimant.’”) (quoting David T. Austern, *Presentation at the American Bankruptcy Institute Winter Conference*, Dec. 4, 2003, at 6).

<sup>550</sup> RAND, *supra* note 2, at 102.

<sup>551</sup> *Id.* at xxix.

<sup>552</sup> See Porter, *supra* note 30, at 229.

there are cases that lend some support to this conclusion.<sup>553</sup> But the payment history of the trusts indicates that non-debtor contributions have not been nearly large enough. And because it is likely that every one of the Chapter 11 plans that established the struggling trusts also released the contributing non-debtor, the asbestos claimants have lost the opportunity to seek compensation for their injuries from potentially liable parties.<sup>554</sup>

It is true that other § 524(g) provisions (1) indirectly address the prospect of the debtor encountering new financial problems,<sup>555</sup> and (2) require that the trust be in a financial position to pay present and future claims “in substantially the same manner.”<sup>556</sup> Moreover, § 1129(a)(10) mandates that the plan be feasible.<sup>557</sup> But despite these protections, the “fair and equitable” language is best understood as heightening the necessary certainty that the trust will have sufficient assets when a channeling injunction applies to future claimants. After all, such claimants are incapable of participating directly in the formulation of the plan of reorganization; rather, they are represented by a future claims representative,<sup>558</sup> who arguably does not get to vote on the plan.<sup>559</sup> By mandating greater certainty that the plan will be successful, the “fair and equitable” requirement assures that other constituencies will not formulate a plan that forces future claimants to bear undue risk.

This reading of § 524(g) is even more compelling when the supplemental injunction protects non-debtors. The best interests test already requires that present and future claimants be promised payment in full on any claims barred by the injunction (at least in most circumstances). The most logical additional

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<sup>553</sup> See, e.g., *In re Quigley Co.*, 377 B.R. 110, 114-15 (Bankr. S.D.N.Y. 2007) (noting that the debtor and Pfizer, its parent, would be funding the litigation trust with \$645 million dollars, enough to permit asbestos claimants to recover in full); *In re J T Thorpe Co.*, 308 B.R. 782, 790 (Bankr. S.D. Tex. 2003) (Thorpe Corporation, the parent of the debtor and one of the released parties, (1) pledged its equity in the debtor to secure a loan to the debtor, (2) promised to loan up to 3.5 million to the debtor, (4) released their claims to shared insurance with the debtor, and (4) contributed various other miscellaneous funds and assets), *order entered by*, No. 02-41487-H5-11, 2003 WL 23573844 (Bankr. S.D. Tex. Jan. 17, 2003), *aff'd*, No. 02-41487-H5-11, 2004 WL 720263 (S.D. Tex. Mar. 3, 2004).

<sup>554</sup> *But cf.* Shelley, *supra* note 32, at 258-59 (contending that many personal injury plaintiffs have improperly recovered from multiple litigation trusts, thus receiving *more* than full payment on their claims).

<sup>555</sup> See 11 U.S.C. § 524(g)(2)(B)(i)(III) (2006) (requiring that the trust be given at least the contingent right to own a majority of the voting shares of the debtor or related affiliates). The “contingency” that grants a trust control of the debtor must be an event that would occur prior to the point in time when obtaining control of the debtor would be worthless. *In re Congoleum Corp.*, 362 B.R. 167, 176 (Bankr. D.N.J. 2007).

<sup>556</sup> See 11 U.S.C. § 524(g)(2)(B)(ii)(V).

<sup>557</sup> *Id.* § 1129(a)(10).

<sup>558</sup> See *id.* § 524(g)(5)(A) (providing that “the term ‘demand’ means a demand for payment, present or future, that . . . was not a claim during the proceedings leading to the confirmation of a plan of reorganization” (emphasis added)); *id.* § 524(g)(4)(B)(i) (providing for the appointment of a future claims representative).

<sup>559</sup> See *supra* notes 385-86 and accompanying text.

function that the “fair and equitable” standard could serve is greater assurance that future claimants will in fact receive full compensation if their right to pursue non-debtors is extinguished by a channeling injunction.

In essence, I would read the § 524(g) “fair and equitable” requirement to mandate greater certainty than mere “feasibility”<sup>560</sup> that the plan will be able to pay future claims, whether the supplemental injunction protects both the debtor and third-parties, or just the debtor.

When assessing the assurance required by the “fair and equitable” standard, courts should take careful note of the fact that large numbers of § 524(g) trusts have failed to fulfill their plan obligations. Given this state of affairs, the “fair and equitable” principle suggests that when courts issue supplemental injunctions that protect third-parties they should consider specifying that the relief granted is only a *provisional injunction*, not a full-blown non-debtor release. Recall how provisional injunctions operate.<sup>561</sup> Unlike third-party releases, a provisional injunction does not permanently enjoin or otherwise extinguish the creditor’s claim against the third party the day the plan is confirmed. Instead, it merely stays the creditor’s right to pursue the third party. If the plan’s promise of payment in full is satisfied, the injunction becomes permanent. But if the debtor defaults, the injunction is lifted and the creditor can pursue the non-debtor. Hence the name *provisional* injunction; permanent relief for the protected non-debtor is *contingent* upon the creditor receiving total satisfaction of its debt.<sup>562</sup> The distinguishing feature of a provisional injunction is that, contrary to a non-debtor release, it places the risk of plan failure on the benefitting non-debtor rather than the creditor.

Nothing in § 524(g) suggests that the supplemental injunction must be permanent.<sup>563</sup> The injunction need merely “supplement the injunctive effect of a discharge.”<sup>564</sup> True, § 524(g)(3)(A)(i) states that, upon issuance or affirmance by the district court “the injunction . . . may not be revoked or modified by any court except through appeal in accordance with paragraph (6).”<sup>565</sup> But this language does not rule out an injunction that expires *by its own terms*, as opposed to revocation or modification by a court. Moreover, § 524(g)(2)(A) states that “after entry of such injunction, any proceeding that involves the validity,

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<sup>560</sup> See *supra* note 228 and accompanying text (discussing the “feasibility” requirement of 11 U.S.C. § 1129(a)(11) (2006)).

<sup>561</sup> See also *supra* notes 237-41 and accompanying text.

<sup>562</sup> For a pre § 524(g) asbestos bankruptcy in which the plan contained a provisional injunction rather than a non-debtor release, see *The New National Gypsum Co. v. The National Gypsum Co. Settlement Trust (In re National Gypsum, Co.)*, 219 F.3d 478, 486 (5th Cir. 2000) (channeling injunction protecting third parties did not bar asbestos claimants from suing the third parties “after exhausting the remedy or remedies provided by the [Trust]”).

<sup>563</sup> In *In re Combustion Engineering, Inc.*, the future claims representative proposed, during the negotiations, that the “§ 524(g) injunction would be reevaluated if ABB Limited [the debtor’s ultimate parent] defaulted on its obligations under the Plan.” 391 F.3d 190, 206 n.10 (3d Cir. 2004). In other words, he proposed a provisional injunction.

<sup>564</sup> 11 U.S.C. § 524(g)(1)(A) (2006).

<sup>565</sup> *Id.* § 524(g)(3)(A)(i).

application, construction, *or modification* of such injunction . . . may be commenced only in the district court in which such injunction was issued.”<sup>566</sup>

One subparagraph says no modification is permissible; another says an action to modify must be brought before the issuing court. The best way to reconcile these two provisions is as follows: Subparagraph (2)(A) permits modifications expressly contemplated by the initial terms of the plan of reorganization or confirmation order, and subparagraph (3)(A)(i) bars all other changes.<sup>567</sup>

Of course, provisional injunctions do not provide third parties the finality they crave. Only non-debtor releases do that.<sup>568</sup> But if a third party desires certainty, it should have to contribute sufficient assets to make the success of the plan more than merely “feasible.” The contributions should convince the court that plan success, and thus full payment of any third-party claims, is highly likely.<sup>569</sup>

In short, given the payment history of most asbestos litigation trusts, while the protection provided by the best interests test seems broad, any promise to future claimants of payment in full on claims extinguished by a § 524(g) release may turn out to be hollow. If such promises are to have value, a heightened feasibility requirement is essential. And if that stricter standard is not satisfied in the eyes of the court, a § 524(g) provisional injunction should be the maximum relief granted to non-debtors.

## VII. CONCLUSION

The asbestos crisis has inspired courts and legislatures to develop some of the most radical remedies in the American legal system. Non-debtor releases are a signature example. But like other powerful remedies, non-debtor releases are subject to abuse, as this Article demonstrates. Courts have consistently granted third-party releases that violate established legal principles.

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<sup>566</sup> See also *id.* § 524(g)(2)(A) (emphasis added).

<sup>567</sup> But see *In re W. Asbestos Co.*, 313 B.R. 832, 855 (Bankr. N.D. Cal. 2003) (“While an injunction is an equitable remedy, in this instance, the equities are built into 11 U.S.C. § 524(g). If those equities are satisfied, the Court does not believe that it has the discretion to limit the effect of the supplemental injunction to something *less than permitted by statute*.” (emphasis added)).

<sup>568</sup> And thus non-debtors seeking a release are likely to vigorously challenge any proposal that a court issue only a provisional injunction under § 524(g). After all, supplemental injunctions and their related litigation “trusts have thus far successfully contained liability and prevented the continued pursuit of parent companies, subsidiaries, and buyers for mass tort liability.” Johnston & Porter, *supra* note 31, at 514. Indeed, “[e]ven when the asbestos trusts turn out to be underfunded, there has been no suggestion that asbestos plaintiffs have recourse against the reorganized debtors or their parents or affiliates.” *Id.* But that is only because the injunctions included in the plans have been permanent rather than provisional.

<sup>569</sup> Cf. 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][b][ii], at 1129-109 to 1129-110 (15th ed. rev. 2004) (explaining that the courts are essentially construing the cramdown “fair and equitable” standard to require a heightened showing of feasibility when they find invalid reorganization plans that “unfairly or unreasonably” shift the risk of plan failure from junior to senior creditors).

Asbestos reorganizations are generally enormous cases of staggering complexity. In the quest for a speedy resolution to such cases, courts and litigants have understandably looked for legal shortcuts. The extraordinary circumstances in asbestos insolvencies do not, however, justify disregarding fundamental protections set forth in the Bankruptcy Code. Nonetheless, that is precisely what has happened in these cases. Most crucially, asbestos tort claimants have been deprived of their rights guaranteed by the best interests of creditors test. I hope that this Article will prompt courts and parties to adopt a new approach in asbestos bankruptcies, one that assures that § 524(g) supplemental injunctions and other non-debtor releases are granted only after a full consideration of the statutory limits on this form of relief.