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Chained to the drawing board

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SHARE E-MAIL RETURN TO FULL STORY

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The heyday of asbestos bankruptcies is long over. At the start of the decade, a steady stream of companies paraded into bankruptcy, and after years of battling over what asbestos claims were worth, how victims should be compensated and settlements funded, a mass exodus occurred. In 2006 alone, **Owens Corning**, **Armstrong World Industries Inc.**, **USG Corp.**, **Federal-Mogul Corp.**, **Babcock & Wilcox Co.**, Combustion Engineering Inc. and **Kaiser Aluminum Corp.** bolted from Chapter 11, freed from billions of dollars of liabilities.

But flooring maker Congoleum Corp. remains. Congoleum did file much later than the others, on Dec. 31, 2003, rather than 2000 or 2001. And there remain a few asbestos debtors -- **W.R. Grace & Co.** and **Pittsburgh Corning Corp.**, which filed in 2001 and 2000, respectively -- with longer cases. But many thought Congoleum would be well out of bankruptcy by now, leaving its asbestos pain behind. Instead, it languishes in Chapter 11, beset by problems.

After more than five years and 11 amended reorganization plan proposals, a fed-up Judge Kathryn Ferguson of the U.S. Bankruptcy Court for the District of New Jersey in Trenton on Feb. 26 dismissed Congoleum's filing altogether, labeling the company's latest plan to compensate asbestos claimants as unconfirmable as the plan it offered in 2007. The only thing standing between litigants holding $491 million in claims and a crush of court dates for adjudicating them is a stay that Ferguson imposed so Congoleum can pursue an appeal to the U.S. District Court for the District of New Jersey.

"Confirmability has been an issue in a number of mass tort cases," says a veteran bankruptcy attorney not involved in the case, Sandra Mayerson of **Squire Sanders & Dempsey LLP**. "Many have gone through several iterations of a plan until they finally got it right. I am not aware of another plan, however, where the case was dismissed because it was unconfirmable. Usually, the plan proponents keep going back to the drawing board until they get it right."

When Congoleum filed for Chapter 11, it did so armed with a prepackaged plan. So confident was the Mercerville, N.J., manufacturer that it predicted in a Form 10-Q filed with the Securities and Exchange Commission three months after its filing that it would emerge no later than the end of 2004.

Few attorneys involved in the case would comment, but one who did, bondholders' counsel Ronald Reinsel from **Caplin & Drysdale Chartered**, blames Congoleum's insurers, who are mostly on the hook to fund payouts to asbestos claimants. Reinsel, who supports Congoleum's plan, blames them for stalling. "From the view of the plan proponents, each time the judge identified a problem with the company's plan, the proponents attempted to resolve it," he says.

The insurers, meanwhile, argue that Congoleum over a number of years failed to address flaws in the settlement and to deal with Ferguson's concerns. And, in fact, Ferugson did seem to lose patience with Congoleum. In a two-part opinion issued on June 5 and Sept. 2, Ferguson rebuked the company and its creditors for being no further along than five years ago. "Regrettably," she wrote, "after a dozen tries and even with a joint plan supported by the key creditor constituencies, the debtors still cannot extricate

themselves from the morass that has made their previous plans unconfirmable."

Today, Congoleum, which Scottish immigrants founded in the 1880s, loses money. Its sales of $172.6 million last year were less than the $204.3 million it had in 2007, but its operating losses were more limited too: Its $16.3 million operating loss in 2008 was an improvement on the $28.3 million operating loss it took a year before. The situation would have been worse if its asbestos liabilities were counted, which they're not -- at least for now. By the time it filed, Congoleum had amassed more than 100,000 asbestos-related injury claims related either to asbestos-backed vinyl flooring it stopped manufacturing in 1983 or to asbestos-backed resilient tile last made in 1974.

The company didn't disclose just how much in dollar terms these claims were worth -- the $491 million figure is from its 2008 10-K. According to a spokesman, Congoleum settled with 131 claimants before filing -- either individually or in small group settlements -- and reached a larger agreement with some 79,000 claimants that would pay claimants based on their degree of illness.

Three of those claimants -- Edward Comstock, Kenneth Cook and Richard Arsenault -- are now deceased but still figure prominently in the case.

The Congoleum prepack was modeled after one used by Combustion Engineering, which channeled asbestos claims into a trust while simultaneously protecting CE's nondebtor affiliates. Congoleum, too, funneled claims into a trust that would permanently assume its asbestos liabilities. Congoleum was to contribute only a $2.7 million promissory note to the trust, payable 10 years after confirmation, while its parent, **American Biltrite Inc.**, added $250,000 in cash and pledged its shares in Congoleum to secure the note. Insurer payments would also go into the trust, funding all pending and future claims.

The prepack was designed to comply with Section 524(g) of the U.S. Bankruptcy Code, which gives special attention to asbestos claimants that have not been identified. Under Section 524(g), 75% of claimants must approve a plan of reorganization for it to be confirmable. It also mandates that the criteria for differentiating between classes of claimants is their varying degrees of illness.

Despite filing a prepack, Congoleum from the start has been at odds with its insurers over responsibility for millions of dollars in asbestos liabilities. The prepack blew up quickly over the issue and by November 2004, Congoleum was already on its fourth modified plan. In dispute, says the Congoleum representative, was the equality requirements for all asbestos litigants imposed by Section 524(g). The company wanted to achieve equality for current and future claimants while also recognizing contractual rights of those claimants it settled with before filing for Chapter 11.

Congoleum thought it had solved this problem when it filed a sixth amended plan in July 2005. Under it, asbestos claimants who settled with the company before the filing would forgo collecting and would instead share equally in distributions from the trust. But the plan was withdrawn after some claimants decided not to go along with it.

By March 2006, Congoleum had lost its exclusive right to file a plan, enabling insurer **Continental Casualty Co.** and its affiliate Continental Insurance Co., as well as its bondholders, to submit rival proposals.

Ferguson then ordered that warring factions submit to mediation during the summer of 2006, after which Congoleum, now allied with the asbestos claimants' committee, filed a ninth plan while the insurers and bondholders banded together to put forth a competing one. But by October, the bondholders, as well as the future claimants representative, switched to Congoleum's camp, and the company filed a 10th plan. The insurers, now alone, submitted another one, too. Ferguson in February 2007 rejected both as unconfirmable.

But it wasn't until last summer that Ferguson became particularly miffed. Twice -- June 5 and Sept. 2 -- she again deemed Congoleum's plan unconfirmable. Why? The joint plan broke down the company's present asbestos claimants into two classes of creditors: those that hadn't settled with Congoleum before it filed for Chapter 11 (class 7A), and those that had (class 7B).

The plan allowed settling claimants the right to also collect from the company's estate or from proceeds of its adversary proceedings. In comparison, nonsettling claimants, including future asbestos claimants,

would only collect from the estate.

Meanwhile, the difference in the awards between 7A and 7B claimants was not trivial. Under Congoleum's plan, settling claimants could receive up to $8 million apiece, regardless of the degree of their medical conditions. In comparison, the maximum award for asbestos claimants under the 7A umbrella with mesothelioma, the most common medical ailment caused by asbestos exposure, hung at around $720,000.

This plan drew criticism from the U.S. trustee overseeing the case. "Since the submission of the 10th modified plan of reorganization, the parties have attempted to address the composition of the tort claimants by placing them in one unsecured creditor class under Class 7," the U.S. trustee said. "However, while the gap may have been narrowed by this general classification, the joint plan is still honoring favored treatment of holders of claims under their pre-petition settlement agreements under class 7B."

Even so, Ferguson remained charitable. She put off two issues the insurers raised about Congoleum's plan, one involving a put/call agreement and another regarding provisions that protected the debtor and others from legal action. She also refrained from converting Congoleum's case to a Chapter 7 liquidation or dismissing it altogether, likening both options to using a "sledge hammer to open a nut." But Ferguson did say she would reconsider a conversion or liquidation if the court didn't get a confirmable plan by year's end.

With the company's case hanging in the balance, Congoleum's only hope seemed now to hinge on resolving issues related to its treatment of asbestos claimants. A settlement agreement approved by the bankruptcy court on Oct. 31 almost seemed to do just that, since it released Congoleum from obligations tied to the prepetition settlements and required that claimants planning to file a proof of claim against its estate relinquish their rights to these awards. Congoleum filed a plan -- its 12th overall, 11th amended -- that incorporated the settlement on Nov. 14.

The insurers objected to this one, too. Tancred Schiavoni of **O'Melveny & Myers LLP**, who represents insurers **Century Indemnity Co.**, **ACE American Insurance Co.** and ACE Property and Casualty Insurance Co., says the settlement still had many of the same flaws of Congoleum's previous plans and contained many of the same provisions that Ferguson had already found objectionable. While the settlement targeted a core issue in Congoleum's plan by eliminating provisions treating certain personal injury more favorably than others, it failed to eliminate others, he says. "They strangely negotiated with the judge to see what they could get away with and were essentially playing chicken," Schiavoni says.

Though Reinsel and the other proponents had been hopeful that their plan would be confirmed after its settlement agreement was approved by the court, they were surprised when Ferguson invited further summary judgment, or a resolution without the matter going to a full trial. In January, more than 20 insurers, led by **First State Insurance Co.** and **Twin City Fire Insurance Co.**, further charged that even with the addition of its recently approved settlement agreement, Congoleum's plan still treated certain claimants preferentially.

The insurers argued that Congoleum had already made partial payments to three claimants -- Comstock, Cook and Arsenault -- and that because other claimants had not received these payments, the plan continued to treat them unfairly.

Reinsel says it's typical of any company facing asbestos-related liabilities to settle with some claimants before filing. Meanwhile, a Jan. 22 response filed by Congoleum charged that these claimants had already agreed to request no further payments.

The insurers also railed against provisions in the newest plan to pay claimants' attorneys Perry Weitz of **Weitz & Luxenberg PC** and Joseph Rice of **Motley Rice LLC**. On Jan. 22, the plan proponents fired back, charging that the insurers' objections over the review of Weitz's and Rice's prepetition fees did not constitute a valid reason for the plan to be deemed unconfirmable because Congoleum intended to have the court review those fees.

Then Congoleum and plan proponents attacked insurers directly. "It is telling that the only parties-in-interest in these bankruptcy cases who have raised summary judgment ... are the insurers, non-creditors, who, since August 2002, have failed to provide insurance to the debtors and are the only entities who

apparently benefit from delay of confirmation of a reorganization plan," Congoleum argued.

It's difficult to say whether Ferguson was sympathetic to insurers or frustrated that the plan didn't adequately address the fairness matter. But this time, she wasn't so kind, dismissing Congoleum's bankruptcy filing.

Congoleum began the appeal process the next day, on Feb. 27, filing a notice of appeal of the summary judgment order. The official committee of bondholders in the case did the same.

The battle between Congoleum and its insurers will likely only intensify. Besides the dismissal itself, Ferguson left other matters for the higher court to decide. The U.S. District Court must adjudicate just how "insurance-neutral" Congoleum's plan is or whether the plan infringes on the rights of its insurers. Meanwhile, the transfer of insurance policies to liquidating trusts is an issue that can result in heated debate, as it did in Combustion Engineering's Chapter 11 case. When its insurers argued that their agreements with CE were nontransferable to a 524(g) trust, a bankruptcy court agreed.

Then there are the two fairness issues insurers raised on which Ferguson didn't rule.

One centered on a put/call agreement that insurers argued could result in bondholders purchasing up to 50.1% of Congoleum's reorganized stock from the trust for up to $7.5 million.

The other relates to plan provisions that protect not only the reorganized Congoleum and its affiliates, but future representatives, the claimants' and bondholders' committees and "each of their respective representatives."

No one knows just how much patience the U.S. District Court will show for insurers and their assertions -- and for Congoleum's inability to come up with anything that gets over the preferential treatment hurdle. But Squire Sanders' Mayerson isn't surprised it's gotten to this point. She explains that before the addition of Section 524(g) in 1994, there was no legal mechanism for companies to deal with future asbestos liabilities. Though companies and insurers could get a bankruptcy court to issue a so-called channeling injunction protecting them from future liabilities, there was no legal guarantee that the injunctions would actually hold up, she says. The introduction of 524(g) made these channeling injunctions virtually unchallengeable, and both insurers and companies knew they would be protected.

"Insurers almost welcomed [channeling injunctions]," she says. "It was a chance to settle claims into one trust, and then both a company and its insurers would know they were done."

Mayerson argues that conflicts between insurers and companies intensified as different constituencies got greedier and demanded larger shares. "Trusts were bankrupted before future claimants were paid anything," she says.

As a result, insurance companies, which saw policies exhausted in trusts, were no longer willing to go along. This, Mayerson says, is when the system began to break down. "Congoleum got caught in the middle," she says. "It thought that it was operating under one set of rules, and the rules changed."

Another attorney not involved in the case, **Wiley Rein LLP**'s Laura Foggan, says that while rancor between Congoleum and its insurers is not commonplace, it has occurred in other asbestos bankruptcies involving companies such as Combustion Engineering, **J.T. Thorpe Co.** and **Fuller-Austin Insulation Co.** "To the extent bankruptcy court confirmation orders and/or reorganization plans will alter insurers' contractual and equitable rights, insurers have been forced to contest them," she says. "In general, there are many very valid concerns that insurers have raised with respect to plans of reorganization, including that they may curtail insurers' rights to require consent to settlement of claims, undermine insurer rights to control or associate in the defense of claims and determine defense strategy, improperly assign insurance policies to the bankruptcy trust in violation of explicit anti-assignment clauses in the insurance contracts, supplant judicial resolution of underlying claims with a dispute resolution mechanism, alter the basis for and accelerate insurer payments and change or curtail insurer contribution rights."

Bondholders' counsel Reinsel doesn't believe insurers have had rights curtailed at all. He chides the court as particularly "solicitous of the insurers," giving them every chance to present objections. "They have

chosen this [case] as their poster child to throw everything they can at having a plan confirmed. The insurers would only agree to a plan where they control the process and could avoid all liability."

That could probably be said of many bankruptcy constituencies, though Congoleum and its creditors haven't done themselves any favors, and few judges are as patient as Ferguson.

Meanwhile, it's back to the drawing board one more time.

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