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Effective Insurance Neutrality Language Deprives Insurers of Standing in Delaware

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Editor's Note: See the feature on page 36 that also discusses the Leslie Controls case, but covers the common-interest doctrine as it applied to the case.

The case of *In re Leslie Controls Inc.*² adds to the growing precedent in the Third Circuit that effective insurance-neutrality provisions will deprive a debtor's insurers of standing to object to a plan of reorganization proposed pursuant to 11 U.S.C. § 524(g). Plan language that is properly crafted to preserve insurer rights and defenses for post-confirmation coverage litigation in a nonbankruptcy forum will be deemed neutral, therefore eliminating any standing that insurers otherwise may have to object to the plan, and even to participate in the confirmation hearing.

Faced with escalating claims for asbestos-related personal injuries, Leslie Controls Inc. filed for chapter 11 protection on July 12, 2010.³ Concurrently, Leslie filed a reorganization plan that it had negotiated pre-petition with an *ad hoc* committee representing asbestos plaintiffs and the debtor's proposed legal representative for future asbestos personal-injury claimants.⁴ Subsequently, the U.S. Trustee appointed the committee of

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unsecured creditors and the bankruptcy court appointed the legal representative for future claimants (FCR), both of which became supporters of Leslie's proposed plan.⁵

Pursuant to § 524(g), Leslie's plan proposed the establishment of a settlement trust and an injunction that would channel to the trust all current and future asbestos-related claims.⁶ Leslie and its parent corporation would fund the trust by contributing, among other things, rights to proceeds from insurance policies and insurance-settlement agreements.⁷ The plan included provisions based on Third

of standing to object to confirmation and precluded them from participating in the confirmation hearing.⁸ On Oct. 28, 2010, Judge Sontchi confirmed the (otherwise uncontested) plan.⁹

Debtor-Proposed Insurance Neutrality Language

Third Circuit precedent generally held that "insurance neutrality" exists when a plan has no adverse effect on the rights, defenses or obligations of the debtor's insurers.¹⁰ A plan that expressly preserves such rights, defenses or obligations for post-confirmation insurance-coverage litigation in a nonbankruptcy forum will be deemed insurance neutral, and the unimpaired insurers will lack standing to object to the plan.¹¹

Leslie premised its insurance-neutrality language¹² on that approved in

Insurance Issues

Circuit precedent that were intended by the debtor to render the plan neutral with respect to Leslie's insurers.

Several insurers objected to Leslie's plan, propounded discovery to and took depositions of the debtor and the plan supporters, and were prepared to participate in the confirmation hearing and present evidence showing the plan's lack of neutrality. The debtor, joined by the committee and FCR, moved to strike the objections on the basis that the plan's insurance-neutrality provisions deprived the insurers of standing. At the commencement of the confirmation hearing on Oct. 26, 2010, Hon. **Christopher S. Sontchi** held that the plan's insurance-neutrality provisions deprived insurers

*In re Combustion Engineering Inc.*¹³ In an attempt to address the insurers' concerns, *Leslie* broadened the neutrality provisions to incorporate language that one of Leslie's insurers had negotiated and agreed to in *In re G-1 Holdings Inc.*¹⁴ Specifically, the debtor added provisions to clarify that (1) the forum for a coverage action is a nonbankruptcy court, (2) the neutrality provision can be used by either side in coverage litigation, (3) the parties are required to stipulate that the neutrality provision is binding upon them

¹ Young Conaway is counsel to James L. Patton, Jr., the FCR in the *Leslie* case.

² See *In re Leslie Controls Inc.*, Case No. 10-12199 (CSS), Oct. 26, 2010, Transcript (Bankr. D. Del.) (*Leslie Tr.*); *In re Leslie Controls Inc.*, Case No. 10-12199 (CSS), Findings of Fact, Conclusions of Law and Order Confirming the First Amended Plan of Reorganization of Leslie Controls Inc. under Chapter 11 (Bankr. D. Del. Oct. 28, 2010) (the "*Leslie Confirmation Order*"). Confirmation of the *Leslie* plan and various issues appealed by the insurers are now pending before the District of Delaware as Case Nos. 10-850, 10-924 and 10-1002.

³ *Leslie Confirmation Order* at 1, 21.

⁴ *Id.* at 2.

⁵ *Id.* at 9-10.

⁶ See *id.* at 21-22, 46-47.

⁷ *Leslie Tr.* at 57; see also *Leslie Confirmation Order* at 22.

⁸ *Leslie Tr.* at 45-49.

⁹ See *Leslie Confirmation Order* at 57.

¹⁰ See, e.g., *In re Combustion Engineering Inc.*, 391 F.3d 190, 217-18 (3d Cir. 2004); *In re Pittsburgh Corning Corp.*, 417 B.R. 289, 315-16 (Bankr. W.D. Pa. 2006).

¹¹ See *Combustion Engineering*, 391 F.3d at 218; *Hartford Acc. & Indem. Co. v. Global Indus. Techs. Inc.*, 2008 U.S. Dist. LEXIS 108185, *10-13 (W.D. Pa. July 26, 2008); *Pittsburgh Corning*, 417 B.R. at 317.

¹² See *Leslie Confirmation Order* at 37-39.

¹³ 391 F.3d 190 (3d Cir. 2004).

¹⁴ *In re G-1 Holdings Inc.*, 420 B.R. 216, 242-43 (Bankr. D. N.J. 2009). *Leslie Tr.* at 15-16.

in coverage litigation and (4) “nothing in this proceeding could be used as evidence of any determination regarding the insurers’ liability or coverage obligation for any claim.”¹⁵

Leslie argued that its neutrality language preserved all of the insurers’ rights and defenses, depriving them of any injury and therefore of standing under the precedent established by the Third Circuit in *Combustion Engineering, Hartford Acc. & Indem. Co. v. Global Indus. Techs. Inc.*,¹⁶ *In re Federal-Mogul Inc.*¹⁷ and *In re Pittsburgh Corning Corp.*¹⁸ It further argued that the insurers wanted not neutrality, but “to tilt the playing field in their favor in a subsequent coverage action and decidedly so.”¹⁹ Despite having taken discovery, the insurers’ objections cited no evidence demonstrating that the plan was not neutral.²⁰ Moreover, the debtor noted, the plan did not require any insurer to contribute to the trust, did not depend on any particular insurance recovery and fully reserved the insurers’ ability to establish they had no coverage obligation when asked to pay.²¹

Insurers Objected to Leslie Plan as Lacking Neutrality and Harming Their Rights

The five insurers that objected to the *Leslie* plan argued that the plan was not neutral and deprived them of their legal, equitable, contractual and pecuniary rights and interests.²² They argued that the plan harmed them by, *inter alia*, changing certain pre-petition practices observed by the insurers and Leslie. For example, the insurers argued that the plan eliminated the role that the insurers played in defending claims pre-petition and would result in accelerated and increased payment of claims.²³ In addition, whereas Leslie had vigorously defended against claims prior to the bankruptcy filing, the insurers argued that Leslie had allowed the very claimants to whom it was adverse pre-petition to direct the procedures and establish that the values for payment of claims under the plan and proposed trust.²⁴

The insurers claimed that the neutrality language had to be tailored specifically to Leslie’s plan rather than simply mimic

what courts approved in other cases.²⁵ Additionally, the insurers argued that one insurer’s previous agreement to similar language was factually distinguishable and of no binding effect.²⁶ The insurers further contended that standing should be determined only after they had an opportunity to present evidence demonstrating the plan’s lack of neutrality.²⁷ They intended to present that evidence during the confirmation hearing through expert testimony and by cross-examining the debtor’s and plan supporters’ witnesses.²⁸

Leslie provides further guidance on Third Circuit precedent with respect to insurance neutrality for parties proposing a plan of reorganization pursuant to § 524(g). Plan language that...preserves insurer rights and defenses for post-confirmation coverage litigation in a nonbankruptcy forum will be deemed neutral...

Insurers Lacked Standing to Object, Participate in Confirmation Hearing

At the commencement of the confirmation hearing, Judge Sontchi granted the debtor’s motion to strike the insurers’ objections.²⁹ The court agreed with the insurers that “this is a matter that the Court needs to be very sure about,”³⁰ but it found that the plan was in fact insurance-neutral and thus deprived the insurers of standing.³¹ Persuaded by rulings from Hon. **Judith K. Fitzgerald** in the *Pittsburgh Corning* case³² and the Third Circuit Court of Appeals in *Combustion Engineering*,³³ the court noted that neutrality depends on the circumstances of each case:

What I think [preservation of insurers’ rights] comes down to is each case has to be judged on the facts of that case, and in this case, you have to look, or I have to look at the plan provisions themselves

and determine whether in the context of what’s going on in front of the Court, they truly—the provisions truly are neutral, they truly preserve the rights of the insurers under the policies and permit them to continue to dispute coverage if necessary.³⁴

The language of *Combustion Engineering* did not constitute “magic words” that had to be reproduced exactly, but the “concept was, in the particular facts that the Court had in front of it, did the language that was at play preserve the rights of the insurers.”³⁵ Because Leslie’s proposed neutrality provision accomplished that concept consistent with *Combustion Engineering* and *Pittsburgh Corning*, the court concluded “that the language in the proposed plan is indeed insurance neutral and that there are no remaining issues in connection with confirmation for which the insurers have standing.”³⁶ As a result, the court prohibited the insurers from participating in the confirmation hearing and did not consider their objections,³⁷ and subsequently entered an order confirming Leslie’s plan.³⁸

Conclusion

Leslie provides further guidance on Third Circuit precedent with respect to insurance neutrality for parties proposing a plan of reorganization pursuant to § 524(g). Plan language that, consistent with the overall context of the plan, preserves insurer rights and defenses for post-confirmation coverage litigation in a nonbankruptcy forum will be deemed neutral, and consequently, the debtor’s insurers will lack standing to object to the plan. ■

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¹⁵ *Id.*
¹⁶ 2008 U.S. Dist. LEXIS 108185 (W.D. Pa. July 26, 2008).
¹⁷ 2007 WL 4180545 (Bankr. D. Del. Nov. 16, 2007).
¹⁸ 417 B.R. 289 (Bankr. W.D. Pa. 2006).
¹⁹ *Leslie Tr.* at 16.
²⁰ *Id.* at 17.
²¹ *Id.* at 22-23.
²² *Id.* at 28.
²³ *Id.* at 29.
²⁴ *Id.* at 29-30.

²⁵ *Id.* at 38.
²⁶ *Id.* at 37-38.
²⁷ *Id.* at 28, 39-40.
²⁸ *Id.* at 29-30.
²⁹ *Id.* at 45-49.
³⁰ *Id.* at 45.
³¹ *Id.* at 47-48.
³² 417 B.R. 289.
³³ 391 F.3d 190.

³⁴ *Leslie Tr.* at 47.
³⁵ *Id.*
³⁶ *Id.* at 48.
³⁷ *Id.* at 49; *Leslie Confirmation Order* at 57.
³⁸ See *Leslie Confirmation Order* at 57.