NEWSSTAND

Debtors Beware: There's Another Sheriff in Town

December 2009

Paul J. Labov

The United States Bankruptcy Court for the District of New Jersey denied *fourteen* plans of reorganization filed by Congoleum Corporation before the court finally dismissed the case on February 27, 2009. While the Congoleum bankruptcy proceedings involve numerous issues, this article focuses generally on insurer standing and specifically, on whether Congoleum's insurers had standing to object to Congoleum's twelfth plan of reorganization.

As a manufacturer of floor tiles and other products, Congoleum faced insurmountable asbestos claims, which severely threatened the viability of the company. After exhausting coverage from its primary insurers, Congoleum sought but failed to obtain coverage from its excess insurers as well.

In an attempt to control its asbestos liabilities, Congoleum devised a pre-packaged bankruptcy plan, the cornerstone of which was a Bankruptcy Code section 524(g) injunction. If approved, the injunction would have channeled all prior and future asbestos-related claims into a trust. The trust was to be funded with Congoleum's assets, including its insurance policies and the proceeds from such policies.

The insurers and several asbestos claimants objected to confirmation of the plan on the grounds that it favored certain asbestos claimants over others and that the required judicial oversight of certain fee provisions was lacking. Congoleum argued that the insurers lacked standing to contest the confirmability of the plan and that, regardless, the plan met all of the requirements set forth in the Bankruptcy Code. The Bankruptcy Court rejected Congoleum's argument that the insurers lacked standing. The court found that the plan threatened substantial harm to their financial and contractual interests because, among other reasons, the plan pre-empted the insurer's anti-assignment and cooperation rights by allowing Congoleum to assign its rights in the policies to the trust. This alone, according to the Bankruptcy Court, constituted an injury-in-fact, made the insurers' parties in interest under the Bankruptcy Code and conferred standing upon the insurers to object to the plan. Also, the Bankruptcy Court recognized that it had the inherent power to review plans for compliance with Bankruptcy Code requirements for confirmation and that this plan did not meet those requirements. Accordingly, the Bankruptcy Court denied confirmation and dismissed the case.

On appeal, Congoleum argued that i) its insurers lacked standing to object to the plan because they were not a "party-in-interest" and ii) in any event, the plan met the requirements of Bankruptcy Code section 1129, and thus, it should have been confirmed. Not surprisingly, the insurers argued that they had standing because it was their policies that were to fund the trust,

and the plan, if confirmed, would threaten substantial harm to their financial and contractual interests by eviscerating their contractual rights under the policies.

The District Court affirmed the Bankruptcy Court in holding that the insurers had standing because the plan threatened substantial harm to their financial and contractual interests. Noting the broad concept of standing afforded to litigants under Article III of the Constitution, the District Court also found that the Bankruptcy Code's concept of standing was just as broad, allowing any party-in-interest to object to a plan. The District Court, however, found that appealing from a Bankruptcy Court order required a more restrictive approach to standing and included "prudential" limitation. Thus each insurer was required to satisfy the "person aggrieved" standard by showing that confirmation would result in an injury personal to that insurer.

In addressing insurer standing, the District Court noted the important role of insurers in these types of cases. Specifically, the District Court recognized that in asbestos bankruptcy cases, claims are typically submitted in accordance with a trust's distribution procedures and often, the insurance policies and the proceeds derived from those policies are the most significant asset that claimants will look to. The District Court found that this was the seventh time a court confronted the issue of insurer standing, each time finding that insurers had standing to challenge plans due to their fundamental stake in the outcome of the bankruptcy proceedings. After stating that each of these courts had found the "injury-in-fact" requirement satisfied by "the unfairness of a plan which binds them contractually and which directly impacts their financial interests…," the District Court concluded that the insurers were parties-in-interest and had standing to challenge confirmation.

What is so important about this case?
Some lower courts had previously held that while insurers clearly satisfy Constitutional standing requirements, these insurers might not meet the "prudential" standing requirement and so could not challenge portions of the plan that did not affect their direct interests. In essence, these courts read the prudential standing requirement into the Bankruptcy Code, superseding the plain "party-in-interest" language set forth in the Bankruptcy Code itself. Accordingly, these courts would not allow insurers to raise general bankruptcy-related objections, as the insurers did in this case, given the need for prudential considerations in a bankruptcy case, i.e., the consideration that a myriad of divergent interests objecting all at once could clog a system designed to move cases towards a successful reorganization. Here, the District Court pushed the "prudential" requirement back to appeals of Bankruptcy Court orders as opposed to objections made at the time of confirmation. Some may argue that the Bankruptcy Court, as well as others, including the United States Trustee, are required to police a plan's compliance with Bankruptcy Code requirements, which would limit the significance of conferring standing on parties to object to a plan on general Bankruptcy Code grounds. While courts are required to police these requirements, now that insurers and other parties-in-interest are given watchdog status, at least in the District of New Jersey, a debtor may be more likely to get it right the first time.

The District Court's decision can be found at 2009 WL 2514172.