

Case No. 10-56543  
(consolidated with Case No. 10-56622)

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IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

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In re THORPE INSULATION COMPANY, *et al.*, *Debtors*.

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MOTOR VEHICLE CASUALTY COMPANY, *et al.*, *Appellants*,

v.

THORPE INSULATION COMPANY, *et al.*, *Appellees*.

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**ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE CENTRAL DISTRICT OF CALIFORNIA**

Appeal from Case No. 2:10-cv-01493-DSF (C.D. Cal.)  
(consolidated with Case No. 2:10-cv-01537-DSF)

*affirming*

Case No. 2:07-bk-19271-BB (Bankr. C.D. Cal.)  
(Jointly Administered with Case No. 2:07-bk-20016-BB)

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**APPELLEES' PETITION FOR REHEARING *EN BANC***

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**TABLE OF CONTENTS**

I. PRELIMINARY STATEMENT ..... 1

II. CONSUMMATION OF, AND RELIANCE ON,  
THE THORPE PLAN..... 3

III. THE PANEL EVADES AND ERODES  
*ROBERTS FARMS*'EQUITABLE MOOTNESS DOCTRINE ..... 5

IV. THE PANEL REDEFINES SUBSTANTIAL CONSUMMATION ..... 9

V. THE SYSTEMIC IMPORTANCE  
OF FINALITY OF CONFIRMATION ORDERS ..... 14

VI. CONCLUSION..... 17

**TABLE OF AUTHORITIES**

	<b>Page(s)</b>
<b>CASES</b>	
<i>In re Adelphia Commc'ns Corp.</i> , 367 B.R. 84 (S.D.N.Y. 2007) .....	6
<i>In re Antiquities of Nev., Inc.</i> , 173 B.R. 926 (B.A.P. 9th Cir. 1994) .....	11
<i>In re AOV Indus., Inc.</i> , 792 F.2d 1140, 1149 (D.C. Cir. 1986).....	6
<i>In re Best Prods. Co.</i> , 177 B.R. 791 (S.D.N.Y. 1995) .....	8
<i>In re Chrysler LLC</i> , 576 F.3d 108 (2d Cir. 2009), <i>vacated</i> , 130 S. Ct. 1015 (2009).....	16, 17
<i>In re Clarke</i> , 98 B.R. 979 (B.A.P. 9th Cir. 1989) .....	8
<i>In re Combustion Eng'g, Inc.</i> , 391 F.3d 190 (3d Cir. 2004) .....	11
<i>In re Eagle Picher Indus., Inc.</i> , No. 96-4309, 1998 U.S. App. LEXIS 31946 (6th Cir. Dec. 21, 1998) .....	7, 8
<i>In re Gotcha Int'l L.P.</i> , 311 B.R. 250 (B.A.P. 9th Cir. 2004) .....	11
<i>In re Marina City Club, L.P.</i> , No. 96-56812, 1998 U.S. App. LEXIS 13407 (9th Cir. June 18, 1998) .....	11
<i>In re Onouli-Kona Land Co.</i> , 846 F.2d 1170 (9th Cir. 1988) .....	16
<i>In re Pub. Serv. Co.</i> , 963 F.2d 469 (1st Cir. 1992).....	6
<i>In re Roberts Farms, Inc.</i> , 652 F.2d 793 (9th Cir. 1981) .....	<i>passim</i>

*In re Specialty Equip. Cos.*,  
 3 F.3d 1043 (7th Cir. 1993) .....7

*In re UNR Indus., Inc.*,  
 20 F.3d 766 (7th Cir. 1994) .....6, 10

*N. Valley County Water & Sewer Dist., Inc. v. Valley Park, Inc.*,  
 92 Fed. Appx. 443 (9th Cir. 2004).....11

*Travelers Indem. Co. v. Bailey*,  
 557 U.S. 137, 129 S. Ct. 2195 (2009).....13

**STATUTES**

11 U.S.C. § 363 .....3, 15, 16, 17

11 U.S.C. § 363(m) .....3, 15, 16

11 U.S.C. § 524(g) .....4, 7, 9, 11

11 U.S.C. § 1101(2) .....11, 12

11 U.S.C. § 1127(b) .....8, 9

**OTHER AUTHORITIES**

13B C. WRIGHT, A. MILLER & E. COOPER, FED. PRAC. & PROC.:  
 JURISDICTION & RELATED MATTERS § 3533.2.3 (3d ed. 2008) .....6

Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55  
 STAN. L. REV. 751, 751-52 (2002).....15

*Summary of the Quarterly Filings to the Court, Year Ended December 31,*  
 2001, [http://www.mantrust.org/FILINGS/q4\\_01/4THQTR01.htm](http://www.mantrust.org/FILINGS/q4_01/4THQTR01.htm) .....13

## I.

### PRELIMINARY STATEMENT

Plan Proponents<sup>1</sup> file this *Appellees' Petition for Rehearing En Banc* of the panel opinion in *Motor Vehicle Casualty Co. v. Thorpe Insulation Co.* (*In re Thorpe Insulation Co.*), \_\_\_ F.3d \_\_\_ (9th Cir. 2012) ("Thorpe"). A copy of the Slip Opinion is attached here to as Exhibit 1.

"Equitable mootness" has been a pillar of chapter 11 practice in this Circuit for over thirty years.<sup>2</sup> *In re Roberts Farms, Inc.*, 652 F.2d 793 (9th Cir. 1981).

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<sup>1</sup> "Plan Proponents" are (i) the chapter 11 debtors Thorpe Insulation Co. and Pacific Insulation Co. that were reorganized and merged into the "Reorganized Debtor" on October 22, 2010 (the "Plan Effective Date"), (ii) the Official Creditors' Committee, and (iii) the court-appointed Future Claims Representative, the Hon. Charles B. Renfrew (Ret'd). The *Fifth Amended Joint Plan of Reorganization of Thorpe Insulation Company and Pacific Insulation Company* (the "Thorpe Plan" or "Plan") was opposed by two groups of non-settling asbestos liability insurers: (i) National Fire Insurance Co. of Hartford and Continental Insurance Co. (together, "CNA"), and (ii) Motor Vehicle Casualty Co., Central National Insurance Co. of Omaha, and Century Indemnity Co. (together, "ACE," and with CNA, "Appellants"). Seventeen other asbestos liability insurers (the "Settling Insurers") settled their Thorpe-related asbestos liability under the Thorpe Plan by making contributions and promises of future contributions that aggregated over \$600 million.

<sup>2</sup> This Court routinely dismisses, or affirms dismissals of, appeals from plan confirmation orders, citing *Roberts Farms* as establishing the Circuit's standard. Petitioners found no fewer than fifteen such decisions of this Court reported on LEXIS alone since 1994. See Appendix of Ninth Circuit Equitable Mootness Cases. Many of these dismissals were grounded on far lesser showings of third-party reliance than existed here. Of course, numerous bankruptcy appellate panel and district court decisions in this Circuit similarly rely on the established *Roberts Farms* standard in dismissing appeals of unstayed confirmation orders as moot.

The panel opinion in this case casts aside this body of law protecting the finality of chapter 11 plans without considering the dramatic consequences for bankruptcy reorganizations. Reorganization plans are complex global settlements that already face enormous obstacles. *Roberts Farms*, however, assured the many interested parties that unless an appellant successfully demonstrated a basis for a stay, the parties could consummate the plan, and remain secure in the rights accorded them under the confirmed plan. After *Thorpe*, however, reliance on an unstayed confirmation order is a game of Russian roulette: As long as appeals pend in the multi-tiered bankruptcy appellate system, commonly for three years or more in this Circuit, the complex multiparty settlement embodied in the confirmed plan remains subject to alteration, perhaps, as in *Thorpe* itself, on the basis of a perceived procedural flaw, without there ever having been identified any substantive defect in the plan or identifiable harm suffered by the appellant.

Inevitably, *Thorpe* will lead to fewer successful plans of reorganization. Third parties will be reluctant to consummate their arrangements in the face of spoilers who, unable to make their peace in the bankruptcy court, threaten to disrupt consummated plans on appeal. Hold-outs will have a disincentive to resolve their differences, and will threaten to disrupt consummated transactions on appeal as leverage to extract additional concessions. This will further accelerate the controversial trend away from reorganization plans confirmed subject to all the

Congressionally-sanctioned constraints of chapter 11 and toward the truncated and much less balanced § 363 sale process. In a § 363 sale, parties who successfully push through the bankruptcy court a quick sale that effectively resolves the case without going through the rigors of the plan process benefit from § 363(m)'s statutory mootness rule, which expressly insulates an unstayed order authorizing the sale of estate property from "reversal or modification on appeal." 11 U.S.C. § 363(m).

The systemic implications of upsetting this Circuit's equitable mootness doctrine by authorizing the reversal or modification of lawfully-consummated reorganization plans, years after they were confirmed and all attempts to stay their implementation failed, is not only worthy of this Court's consideration, it is, given the precedential panel decision issued in this case, a matter that this Court sitting *en banc* now has a duty to address.

## II.

### **CONSUMMATION OF, AND RELIANCE ON, THE THORPE PLAN**

The district court affirmed the Thorpe Plan on September 21, 2010, and hotly-contested litigation immediately ensued between the Plan Proponents and the Appellants over whether a stay would issue pending further appellate review in this Court. All three of Appellants' applications for stay pending appeal were denied, including one submitted to Circuit Justice Kennedy. In reliance on these



stay denials, Plan Proponents implemented the confirmed Thorpe Plan, including by transferring *all* of the property in the debtors' estates to either the § 524(g) asbestos trust created by the Thorpe Plan (the "Trust") or the Reorganized Debtor. By January 2011, the Trust had made initial distributions to asbestos creditors holding liquidated claims. The Trust also promptly began resolving unliquidated claims submitted by individual asbestos claimants in accordance with its administrative procedures. Moreover, complex state court coverage litigation with Appellants recommenced under the Trust's supervisory authority.

Compelling reasons supported the prompt consummation of the Thorpe Plan. Thorpe's asbestos creditors are individuals and their survivors who have suffered personal injuries and death from inhaling asbestos fibers from Thorpe-installed or distributed asbestos insulation. Those individuals with liquidated claims had already waited for payment since at least 2005 when the last of Thorpe's insurers claimed policy exhaustion. The bankruptcy case had stayed holders of unliquidated claims from moving forward to liquidate their claims since 2007. In rejecting Appellants' stay request, the district court found it was "not in the public interest for [the asbestos claimants]—many of whom are presumably seriously ill—to have their compensation delayed for another year or two while Appellants' speculative claims work their way through the appellate process." Dkt. No. 4-3 (Declaration of Jaclyn Blankenship), Tab. 1, at 1-2. Delaying Plan

consummation also would have risked the Reorganized Debtor's and the Settling Insurers' creditworthiness, matters critical to the feasibility of the Thorpe Plan.

By January 24, 2012, when the panel issued its opinion reversing and remanding this case, (i) the debtors had been reorganized and merged into the Reorganized Debtor, which had successfully reentered the marketplace, (ii) the Trust had been created and had commenced processing and settling thousands of individual asbestos claims, (iii) property with a present and future value of over \$600 million had vested in the Trust or the Reorganized Debtor, (iv) \$140 million in cash insurance settlements had been collected from Settling Insurers, (v) the Trust had distributed \$45 million to asbestos claimants and other creditors, and (vi) complex insurance coverage litigation had recommenced in California Superior Court under the direction of the Trust. In short, the rights of thousands of individual asbestos claimants, the commercial creditors of Thorpe, Pacific and the Reorganized Debtor, and seventeen Settling Insurers not before this Court all had intervened.

### III.

#### **THE PANEL EVADES AND ERODES *ROBERTS FARMS'* EQUITABLE MOOTNESS DOCTRINE**

Under *Roberts Farms*, "[i]n the field of the administration of estates under the bankruptcy laws, the policy of the law strongly supports a requirement that a stay be obtained if review on appeal is not to be foreclosed because of mootness."

652 F.2d at 796. Dismissal is the usual result of an appeal from an unstayed order confirming a substantially-consummated plan of reorganization. Indeed, when Appellants sought a stay of the order confirming the Thorpe Plan, the irreparable injury they pled was that a stay was needed to prevent Plan Proponents from substantially consummating the Plan and mooting this Appeal. Dkt. No. 4 (Stay Motion), at 3-4. "[M]any cases rule that substantial implementation of a reorganization plan moots an appeal that—if successful—would cause substantial disruption or defeat significant reliance interests. Mootness often is found even though the appellant sought and was denied a stay." 13B C. WRIGHT, A. MILLER & E. COOPER, FED. PRAC. & PROC.: JURISDICTION & RELATED MATTERS § 3533.2.3 (3d ed. 2008).

As the Seventh Circuit recognized in another mass-asbestos case, "a plan of reorganization, once implemented, should be disturbed only for compelling reasons." *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994). Accordingly, equitable mootness is "presumed when the reorganization plan has been substantially consummated during the pendency of the appeal." *In re Adelphia Commc'ns Corp.*, 367 B.R. 84, 91 (S.D.N.Y. 2007); *see also In re Pub. Serv. Co.*, 963 F.2d 469, 473 n.13 (1st Cir. 1992) (quoting *In re AOV Indus., Inc.*, 792 F.2d 1140, 1149 (D.C. Cir. 1986)) (substantial consummation "raises a 'strong

presumption' that an appellate court will not be able to fashion an equitable and effective remedy").

In *Roberts Farms*, the plan and intervening reliance interests involved many fewer dollars than the \$600 million at stake here. *Roberts Farms* was a standard chapter 11 reorganization of an agricultural debtor that involved none of the unique complexity associated with a § 524(g) mass-asbestos reorganization, including channeling injunctions, a personal injury trust, insurance settlements and the like. If equitable relief could not be fashioned in *Roberts Farms*, then it cannot be fashioned here, where Settling Insurers made significant payments in reliance on the unstayed orders, the debtors merged, the Trust was established and funded, and both the Reorganized Debtor and the Trust have dealt extensively with numerous third parties in transactions that aggregate to tens of millions of dollars.<sup>3</sup>

Moreover, piecemeal modification of a consummated plan is not a suitable alternative to a mootness dismissal under *Roberts Farms* when third-party interests have intervened. *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1049 (7th Cir. 1993) (dismissing appeal because nullifying disputed releases "would amount to imposing a different plan of reorganization on the parties"); *In re Eagle Picher*

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<sup>3</sup> As but one example, Settling Insurers made payments to the Trust totaling \$135,500,000 following, and in reliance on, the district court's affirmance of the Plan confirmation and the occurrence of the Plan Effective Date. Dkt. No. 64 (Declaration of Sara Beth Brown), at 3, ¶ 8.a.

*Indus., Inc.*, No. 96-4309, 1998 U.S. App. LEXIS 31946, at \*18 (6th Cir. Dec. 21, 1998) ("Given that Co-Defendants did not seek a stay, the plan has been substantially consummated, and the relief requested by Co-Defendants would affect the rights of parties not before this Court, we find that modification of the plan is impossible and undesirable."); *In re Best Prods. Co.*, 177 B.R. 791, 802 (S.D.N.Y. 1995) ("[T]he Code provides that it is up to the creditors—not the courts—to accept or reject a reorganization plan."); *In re Clarke*, 98 B.R. 979, 980 (B.A.P. 9th Cir. 1989) ("[P]iecemeal reversal of the confirmed plan would be improper under circumstances wherein 'implementation of the plan has created, extinguished or modified rights, particularly of persons not before the court, to such an extent that effective judicial relief is no longer practically available.'" (citation omitted). This established doctrine is entirely consistent with the basic structure of chapter 11, which contemplates that reorganization plans will effect complex, interdependent, global compromises and therefore forbids plan modification after substantial consummation has occurred, even though prior to substantial consummation, modification, subject to certain procedural steps, is liberally permitted. 11 U.S.C. § 1127(b) ("The proponent of a plan or the reorganized debtor may modify such plan at any time after confirmation of such plan **and before substantial consummation of such plan ....**") (emphasis added).<sup>4</sup>

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<sup>4</sup> The Court should not be distracted by the panel opinion's erroneous reference to (*Continued*)

The *Thorpe* panel opinion forthrightly acknowledged in at least three places that the occurrence of the Plan Effective Date and the intervening implementation of the Thorpe Plan rendered it neither "viable" nor "equitable" "to upset the § 524(g) apple cart." Slip Op. at 673, 674, 687. This should have ended the matter under *Roberts Farms* and its progeny. But it did not, because the panel wished to address standing rulings below with which it disagreed.

#### IV.

#### **THE PANEL REDEFINES SUBSTANTIAL CONSUMMATION**

None of the substantive rulings of the courts below appear to have disturbed the panel. *Id.* at 670 n.5 ("We make no determination that Appellants' rights have necessarily been impaired, except in so far as they were not permitted to be heard on the relevant issues in the bankruptcy court, nor that the plan is necessarily deficient."). Indeed, the panel's only substantive ruling affirmed the critical rulings below authorizing assignment of rights in Appellants' insurance policies to the Trust over Appellants' objections. *Id.* at 683-87. But the panel also found that the bankruptcy court erred in denying Appellants standing to make objections with respect to the "business loss allocation" provisions and the "trust distribution procedures" in the Thorpe Plan—even though those provisions might well be

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Thorpe having purportedly reserved the power to modify the Plan further following consummation. Slip Op. at 672-73. In fact, no such power was reserved.

determined to be lawful over the Appellants' objections on remand. *Id.* at 670 n.5. The panel therefore struggled to find a means of remedying the perceived standing defect without a wholesale unsettling of the Thorpe Plan. It suggested that if, upon remand, the bankruptcy court were to determine that there was legal merit to these objections, "plan modifications" could be constructed such that it would still be viable to implement the Thorpe Plan even though upsetting the Thorpe Plan itself was no longer practical. *Id.* at 673.

*Roberts Farms* and the Ninth Circuit's well-entrenched equitable mootness doctrine, *see supra* Part III & Appendix (citing cases), stood directly in the path of the panel's envisioned solution. It is the entire point of the equitable mootness doctrine that errors below in confirming chapter 11 plans may go uncorrected in the larger interest of protecting the finality of confirmed chapter 11 plans and encouraging third-party reliance on unstayed plan confirmation orders. *See, e.g., UNR Industries*, 20 F.3d at 771 ("Whether one or another detail (for example, the allocation of insurance proceeds and the release of additional claims against insurers) could have been accomplished better is precisely the sort of question that should not upset a substantially consummated plan of reorganization."). Those authorities, as well as § 1127(b), do not permit piecemeal modification of otherwise equitably moot plans. If no stay has been obtained, and if a plan has

been substantially consummated, then the rule in this Circuit is that the plan may not be disturbed if substantial third-party rights have intervened.<sup>5</sup>

The panel overcame the twin obstacles of *Roberts Farms* and the ban on post-substantial consummation plan modification by reinterpreting the statutory term "substantial consummation." The Bankruptcy Code provides, and heretofore all authorities (including unpublished decisions of this Court) agreed,<sup>6</sup>

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<sup>5</sup> The only authority the panel cited (Slip Op. at 672) to support its piecemeal modification approach in circumstances analogous to those here was the decision of the Third Circuit to modify the insurance-neutrality language that the lower courts had added to the § 524(g) plan in *In re Combustion Engineering, Inc.*, 391 F.3d 190, 201-02 (3d Cir. 2004). But there, the plan was subject to a standstill pending the outcome of the Third Circuit appeal and so the plan before the Third Circuit, unlike the Thorpe Plan, had not been consummated at all, let alone substantially consummated, when the Third Circuit ruled. *Id.* at 214. There was no mootness issue at all in *Combustion Engineering*. None of the other cases that the panel relied on in holding that piecemeal modification should be available involved a consummated, complex reorganization like the one in this case.

<sup>6</sup> *See, e.g., N. Valley County Water & Sewer Dist., Inc. v. Valley Park, Inc.*, 92 Fed. Appx. 443, 445 (9th Cir. 2004) ("A plan has been substantially consummated if substantially all of the property has been transferred, the debtor or its successor has taken control of substantially all of the property, and distribution under the plan has commenced. 11 U.S.C. § 1101(2) .... [I]t is clear that the property of the debtor, the Trust, has been transferred to its successor, the Corporation, and the Corporation has begun selling the property to third parties. Consequently, the district court was correct that the plan has been substantially consummated."); *In re Marina City Club, L.P.*, No. 96-56812, 1998 U.S. App. LEXIS 13407, at \*4-8 (9th Cir. June 18, 1998) (plan substantially consummated when substantially all of the property to be transferred under the plan has been transferred or revested in the debtor, even though future payments remain to be made under note issued pursuant to the plan; giving of note qualifies as a transfer); *see also In re Gotcha Int'l L.P.*, 311 B.R. 250, 254 (B.A.P. 9th Cir. 2004); *In re Antiquities of Nev., Inc.*, 173 B.R. 926, 929-30 (B.A.P. 9th Cir. 1994).



in accordance with the plain language of § 1101(2),<sup>7</sup> that if all the estate's property dealt with by the plan has been transferred or revested in the debtor or its successors, the *commencement* of distribution to creditors results in substantial consummation of the plan. The panel nevertheless determined that the Thorpe Plan had not been substantially consummated—even though (i) *all* the property of the estate dealt with by the Plan (including the right to receive future funds under insurer settlements) had been either revested in the Reorganized Debtor or vested in the Trust, and (ii) all commercial creditors and administrative expenses had been paid in full, and the Trust had distributed \$15 million in respect of liquidated prepetition asbestos claims. This, the panel determined, was not "substantial consummation" because ultimately all present and future asbestos creditors would be entitled to receive at least \$600 million in trust funds when distribution is completed, many years in the future—and \$15 million was a modest percentage of \$600 million. Slip Op. at 671-72. For this panel, "substantial consummation"

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<sup>7</sup> Section 1101(2) provides: "substantial consummation" means--

- (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
- (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
- (C) *commencement* of distribution under the plan.

11 U.S.C. § 1101(2) (emphasis added).

requires not *commencement* of distribution, but *completion of a preponderance* of distribution. *Id.* at 671. In a mass tort case involving future claims like this one, this new form of substantial consummation might take decades. Indeed, it is unclear whether the *Johns-Manville* plan itself, confirmed in 1986, would have met the *Thorpe* definition of substantial consummation even fifteen years following its confirmation. By 2001, the trust in that case was still receiving new claims at an "increasing" and "alarming rate," making it simply not possible to ascertain when or whether the "preponderance" test would be met.<sup>8</sup> *Compare Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S. Ct. 2195, 2205 (2009) (*Manville* confirmation order *res judicata* on the question of whether independent tort claims were channeled to the Manville Trust).

Redefining "substantial consummation" overcame the panel's two obstacles: both *Roberts Farms* and the statutory anti-modification rule became inapplicable in the absence of substantial consummation. But in removing the obstacles to reopening the *Thorpe* confirmation hearing to determine whether Appellants' objections to the business loss allocation and trust distribution procedures had merit and, if so, whether an equitable plan modification could be framed, the panel also, perhaps without giving full consideration to the systemic implications of its

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<sup>8</sup> Manville Personal Injury Settlement Trust, *Summary of the Quarterly Filings to the Court, Year Ended December 31, 2001*, available at [http://www.mantrust.org/FILINGS/q4\\_01/4THQTR01.htm](http://www.mantrust.org/FILINGS/q4_01/4THQTR01.htm).

decision, undercut the finality of chapter 11 confirmation orders in this Circuit. In any chapter 11 case of significance, the claim allowance process may stretch out for many years. Final distributions with respect to a preponderance of claims can occur years after plan effectiveness. Liquidating the bankruptcy estate's causes of action through post-confirmation litigation brought by a litigation trust created under a plan—a routinely used device in major cases—and subsequently distributing the litigation proceeds to creditors can be an even longer-term process. Under *Thorpe's* redefinition of substantial consummation, chapter 11 plans now remain up for appellate review and potential piecemeal modification for years after they become effective. This departure from well-rooted doctrine revolutionizes chapter 11 practice in this Circuit. If such a change in the law of the Circuit is warranted (Plan Proponents do not believe it is), the change should come from the Court sitting *en banc*. Moreover, the *en banc* court considering such a change in law should take cognizance of the important policy implications of such a change.

## V.

### **THE SYSTEMIC IMPORTANCE OF FINALITY OF CONFIRMATION ORDERS**

It is impractical in the limited space afforded by a petition for rehearing to undertake a full policy analysis of *Thorpe's* implications for chapter 11 practice. But two obvious points must be noted. Undermining the finality of confirmation orders will make it even more difficult to resolve chapter 11 cases through global

reorganization plans. It reduces the incentive for parties to make their peace in the bankruptcy court and creates risks for settling parties who consummate their approved arrangements before appeals are fully exhausted. It risks empowering spoilers, who will use the threat of disrupting settled arrangements to extract more value from other constituencies. In some cases, this may preclude reorganization altogether if parties decline to consummate the plan pending the appeal, and the fragile settlements and other plan-related commitments cannot be held in place for the duration of the multi-tiered appellate review process. For those plans that are confirmed and consummated, this Court can expect an increase in appeals from imaginative appellants arguing fact-specific questions of whether, and to what extent, a particular form of relief sought would involve inequitably upsetting a consummated plan.

Even more importantly, *Thorpe* will further accelerate the trend favoring § 363 sales over traditional chapter 11 reorganizations. Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 751-52 (2002). Undermining equitable mootness will push even more chapter 11 practice into the § 363 mold because § 363 sales benefit from statutory mootness under § 363(m) that is clearly insulated from the expansive appellate review employed

here.<sup>9</sup> Now in the Ninth Circuit it is clear that finality can best be obtained through the truncated sale process rather than by going through the far more protective chapter 11 plan confirmation process. *In re Onouli-Kona Land Co.*, 846 F.2d 1170, 1171-72 (9th Cir. 1988) (emphasizing, in an appeal from an order authorizing a § 363 sale, the "'particular need' for finality in bankruptcy," that "[f]inality in bankruptcy has become the dominant rationale for our decisions," and trending "towards an absolute rule that requires appellants to obtain a stay before appealing a sale of assets") (citation omitted).

Even while affirming a rapid § 363 bankruptcy sale under the exigent circumstances of the *Chrysler* case during the height of the Great Recession, the Second Circuit noted the troubling features of this tendency to recast reorganization proceedings as § 363 bankruptcy sales:

This tendency [to substitute § 363 sales for traditional chapter 11 plans] has its critics. *See, e.g.,* James H.M. Sprayregen et al., *Chapter 11: Not Perfect, but Better than the Alternative*, Am. Bankr. Inst. J., Oct. 2005, at 1, 60 (referencing those who "decr[y] the increasing frequency and rise in importance of § 363 sales"). ... [T]he thrust of criticism remains what it was in *Lionel*: fear that one

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<sup>9</sup> 11 U.S.C. § 363(m) provides:

The reversal or modification on appeal of an authorization ... of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

class of creditors may strong-arm the debtor-in-possession, and bypass the requirements of Chapter 11 to cash out quickly at the expense of other stakeholders, in a proceeding that amounts to a reorganization in all but name, achieved by stealth and momentum. *See, e.g., [In re Iridium Operating LLC]*, 478 F.3d 452, 466 (2d Cir. 2007) ("The reason *sub rosa* plans are prohibited is based on a fear that a debtor-in-possession will enter into transactions that will, in effect, short circuit the requirements of Chapter 11 for confirmation of a reorganization plan." ...); Brege, *An Efficiency Model of Section 363(b) Sales*, 92 Va. L. Rev. at 1643 ("The cynical perspective is that [§ 363(b)] serves as a loophole to the otherwise tightly arranged and efficient Chapter 11, through which agents of the debtor-in-possession can shirk responsibility and improperly dispose of assets."); *see also* Steinberg, *The Seven Deadly Sins in § 363 Sales*, Am. Bankr. Inst. J., at 22 ("Frequently, ... the § 363 sale process fails to maximize value ....").

*In re Chrysler LLC*, 576 F.3d 108, 116 (2d Cir. 2009), *vacated*, 130 S. Ct. 1015 (2009).

This Court should carefully consider the systemic implications of undermining its *Roberts Farms* precedent in light of considerations like these.

## VI.

### CONCLUSION

The panel decision and judgment should be vacated and this matter should be reheard *en banc*.

Dated: February 7, 2012      Respectfully Submitted,

By:   
\_\_\_\_\_  
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*\* Counsel of Record*

**Certificate of Compliance Pursuant to Circuit Rules 35-4 and 40-1**

I certify that pursuant to Circuit Rule 35-4 or 40-1, the attached petition for panel rehearing/petition for rehearing en banc/answer is: (check applicable option)

Proportionately spaced, has a typeface of 14 points or more and contains 4,200 words (petitions and answers must not exceed 4,200 words); or

Monospaced, has 10.5 or fewer characters per inch and contains \_\_\_\_\_ words or \_\_\_\_\_ lines of text (petitions and answers must not exceed 4,200 words or 390 lines of text); or

In compliance with Fed. R. App. 32(c) and does not exceed 15 pages.

By:



\_\_\_\_\_  
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# Appendix

**Appendix of Ninth Circuit Equitable Mootness Cases Dismissing or Affirming Dismissals of Appeals of Confirmation Orders**

1. *Prime Healthcare Servs., LLC v. Brotman Med. Ctr., Inc.* (*In Brotman Med. Ctr., Inc.*), 442 Fed. Appx. 317 (9th Cir. 2011) (affirming district court dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)
2. *Coleman v. ANMP (In re: Dexter Distrib. Corp.)*, 434 Fed. Appx. 618 (9th Cir. 2011) (affirming district court dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)
3. *Unaffiliated Shareholders v. Mega-C Power Corp. (In re Mega-C Power Corp.)*, 295 Fed. Appx. 242 (9th Cir. 2008) (dismissing appeal from bankruptcy appellate panel partial dismissal of appeal and partial affirmance of settlement order later effectuated by order confirming chapter 11 plan; citing *Roberts Farms*)
4. *Sarma v. Planet Pro, Inc.*, 214 Fed. Appx. 646 (9th Cir. 2006) (dismissing cross-appeal of district court remand of order confirming chapter 11 plan)
5. *Snavely v. Miller (In re Miller)*, 127 Fed. Appx. 380 (9th Cir. 2005) (affirming on basis of equitable mootness district court affirmance of order confirming chapter 11 plan; citing *Roberts Farms*)
6. *N. Valley County Water & Sewer Dist., Inc. v. Valley Park, Inc.*, 92 Fed. Appx. 443 (9th Cir. 2004) (affirming district court dismissal of appeal of order confirming chapter 11 plan)
7. *Aiello v. Connolly (In re Aiello)*, 58 Fed. Appx. 360 (9th Cir. 2003) (affirming district court dismissal of appeal of, *inter alia*, order confirming chapter 11 plan; citing *Roberts Farms*)
8. *Thompson v. One Stop Wireless of Am. (In re One Stop Wireless of Am.)*, No. 00-55480, 2000 U.S. App. LEXIS 33600 (9th Cir. Dec. 15, 2000) (affirming bankruptcy appellate panel dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)

9. *S.N. Phelps & Co. v. Circle K Corp. (In re Circle K Corp.)*, No. 99-16046, 2000 U.S. App. LEXIS 26115 (9th Cir. Oct. 17, 2000) (affirming bankruptcy appellate panel and bankruptcy court orders determining that attempted revocation of order confirming chapter 11 plan was moot; citing *Roberts Farms*)
10. *Seal v. Rimrock Tech. Servs. (In re Rimrock Tech. Serv.)*, No. 98-35189, 1999 U.S. App. LEXIS 25180 (9th Cir. Oct. 7, 1999) (dismissing appeal from district court affirmance of order confirming chapter 11 plan; citing *Roberts Farms*)
11. *In re Saia*, No. 98-15910, 1999 U.S. App. LEXIS 12061 (9th Cir. June 9, 1999) (affirming district court dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)
12. *Annotico v. Marina City Club, L.P. (In re Marina City Club, L.P.)*, No. 96-56812, 1998 U.S. App. LEXIS 13407 (9th Cir. June 18, 1998) (affirming bankruptcy appellate panel dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)
13. *Nicolaysen v. Wells Fargo Bank, N.A.*, No. 94-15722, 1996 U.S. App. LEXIS 4772 (9th Cir. Feb. 6, 1996) (affirming district court dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)
14. *Lurie v. Halderman (In re Marina Int'l Props., Ltd.)*, No. 94-55309, 1995 U.S. App. LEXIS 15061 (9th Cir. June 16, 1995) (affirming bankruptcy appellate panel dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)
15. *S.N. Phelps & Co. v. Circle K Corp. (In re Circle K Corp.)*, No. 93-16278, 1994 U.S. App. LEXIS 5357 (9th Cir. Mar. 15, 1994) (dismissing appeal from district court dismissal of appeal of order confirming chapter 11 plan; citing *Roberts Farms*)

# Exhibit 1

**FOR PUBLICATION**  
**UNITED STATES COURT OF APPEALS**  
**FOR THE NINTH CIRCUIT**

In the Matter of: THORPE  
INSULATION COMPANY,  
*Debtor,*

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MOTOR VEHICLE CASUALTY  
COMPANY; CENTRAL NATIONAL  
INSURANCE COMPANY OF OMAHA;  
CENTURY INDEMNITY COMPANY,  
successor to Cigna Specialty  
Insurance Company, FKA  
California Union Insurance  
Company,  
*Appellants,*

v.

THORPE INSULATION COMPANY;  
PACIFIC INSULATION COMPANY,  
*Appellees,*

NATIONAL FIRE INSURANCE  
COMPANY OF HARTFORD, as  
successor by merger to  
Transcontinental Insurance  
Company; CONTINENTAL INSURANCE  
COMPANY, as successor in interest  
to certain policies issued by  
Harbor Insurance Company;  
OFFICIAL COMMITTEE OF UNSECURED  
CREDITORS, of Thorpe Insulation  
Company and Pacific Insulation  
Company; CHARLES B. RENFREW,  
*Real Parties in Interest.*

No. 10-56543  
D.C. No.  
2:10-cv-01493-DSF

654

IN THE MATTER OF THORPE INSULATION

In the Matter of: THORPE  
INSULATION COMPANY,  
*Debtor,*

NATIONAL FIRE INSURANCE  
COMPANY OF HARTFORD, as  
successor by merger to  
Transcontinental Insurance  
Company; CONTINENTAL INSURANCE  
COMPANY, as successor in interest  
to certain policies issued by  
Harbor Insurance Company,  
*Appellants,*

v.

THORPE INSULATION COMPANY;  
PACIFIC INSULATION COMPANY,  
*Appellees,*

CENTRAL NATIONAL INSURANCE  
COMPANY OF OMAHA; MOTOR  
VEHICLE CASUALTY COMPANY;  
CENTURY INDEMNITY COMPANY,  
successor to Cigna Specialty  
Insurance Company, FKA  
California Union Insurance  
Company; OFFICIAL COMMITTEE OF  
UNSECURED CREDITORS, of Thorpe  
Insulation Company and Pacific  
Insulation Company; CHARLES B.  
RENFREW, Administrative Law  
Judge,

*Real Parties in Interest.*

No. 10-56622  
D.C. No.  
2:10-cv-01493-DSF  
OPINION

IN THE MATTER OF THORPE INSULATION

655

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Appeal from the United States District Court  
for the Central District of California  
Dale S. Fischer, District Judge, Presiding

Argued and Submitted  
August 30, 2011—Pasadena, California

Filed January 24, 2012

Before: Mary M. Schroeder and Ronald M. Gould,  
Circuit Judges, and Richard Seeborg, District Judge.\*

Opinion by Judge Gould

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\*The Honorable Richard Seeborg, United States District Judge for the Northern District of California, sitting by designation.

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**COUNSEL**

David C. Christian, II (argued), Seyfarth Shaw LLP, Chicago, Illinois; James M. Harris, Seyfarth Shaw LLP, Los Angeles, California; Todd C. Jacobs, Grippe & Elden LLC, Chicago, Illinois, for appellants Continental Insurance Company and National Fire Insurance Company of Hartford.

Tancred V. Schiavoni, O'Melveny & Myers LLP, New York, New York; Richard B. Goetz, O'Melveny & Myers LLP, Los Angeles, California; Jonathan Hacker, O'Melveny & Myers LLP, Washington, D.C.; Alan S. Berman, the Berman Law Group, Woodland Hills, California, for appellants Motor Vehicle Casualty Company, Central National Insurance Company of Omaha, and Century Indemnity Company, successor to Cigna Specialty Insurance Company f/k/a California Union Insurance Company.

Thomas E. Patterson (argued), Kenneth N. Klee, Daniel J. Bussel, and David M. Guess, Klee, Tuchin, Bogdanoff &



660

IN THE MATTER OF THORPE INSULATION

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Stern LLP, Los Angeles, California; Jeremy V. Richards and Scotta E. McFarland, Pachulski, Stang, Diehl & Jones LLP, Los Angeles, California, for appellee Thorpe Insulation Company.

John A. Lapinski and Leslie R. Horowitz, Clark & Trevithick, P.L.C., Los Angeles, California, for appellee Pacific Insulation Company.

Peter Van N. Lockwood (argued), Caplin & Drysdale, Chartered, Washington, D.C.; Peter J. Benvenuti, Jones Day, San Francisco, California, for appellee Counsel for the Official Committee of Unsecured Creditors of Thorpe Insulation Company and Pacific Insulation Company.

Gary Fergus, Fergus, A Law Office, San Francisco, California, for appellee Charles B. Renfrew, the Futures Representative.

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**OPINION**

GOULD, Circuit Judge:

The district court affirmed a bankruptcy court's confirmation of a Chapter 11 plan of reorganization under 11 U.S.C. § 524(g), a special provision for the reorganization of companies facing substantial asbestos-related liability. Appellants are several insurance companies that did not reach settlements with Thorpe Insulation Company (Thorpe) and Pacific Insulation Company (Pacific), together the Debtors in bankruptcy court, and who were denied standing to challenge the reorganization plan. The district court held that the reorganization plan was insurance neutral, and so Appellants did not have standing to object to the plan; and it also held that the plan preempted Appellants' state law contract rights. We affirm the district court's conclusion that the plan preempted Appel-

lants' state law contract rights. We disagree with the position of Debtors that the appeal is equitably moot, and, reaching the merits, we reverse the district court's conclusion that Appellants lacked standing. We remand to the district court with instructions that it return the case to the bankruptcy court to give Appellants the opportunity to present their proof and argument.

## I. Background

### A

Thorpe is a California company that distributed, installed, and repaired asbestos insulation products between 1948 and 1972. This led to substantial asbestos-related litigation. In the past thirty years, Thorpe has faced about 12,000 claims and lawsuits for personal injury or wrongful death based on asbestos exposure. Robert and Linda Fults owned Thorpe until 2008, when they transferred their shares to their sons Eric and David Fults. In 2000, Thorpe incorporated Pacific as a wholly-owned subsidiary and conveyed to it the assets associated with its materials division. Robert and Linda Fults were the sole shareholders of Pacific. Pacific, a profitable business, has been named in asbestos-related lawsuits as a successor-in-interest to Thorpe. In 2004, Thorpe sold its remaining assets to Farwest Insulation Contracting ("Farwest"), owned by Eric and David Fults, in a private foreclosure sale. Farwest is also a party to many asbestos-related lawsuits and insurance coverage litigation.

Thorpe purchased insurance policies with many companies that covered "products claims" (or "products/completed operations," for injuries caused by asbestos exposure after a product is relinquished or an operation completed), which are subject to aggregate limits, and "operations claims" (or "non-products," for injuries caused by asbestos exposure before a product is relinquished or an operation completed), which are not subject to aggregate limits. Since 1978, Thorpe's many

insurers have handled the defense and settlement of asbestos suits. Thorpe's insurers paid more than \$180 million defending and indemnifying Thorpe until, in their view, the policies' aggregate limits were exhausted.<sup>1</sup>

## B

Debtors Thorpe and Pacific filed for protection under Chapter 11 of the Bankruptcy Code on October 15, 2007 and October 31, 2007, respectively. Thorpe estimated that, at the time of the bankruptcy filing, 2,000 asbestos cases were pending against it, and Thorpe anticipated that many more suits would be filed in the future.

Thorpe applied to employ the law firms of Snyder Miller & Orton LLP and Morgan Lewis & Bockius LLP as special insurance counsel. Appellants objected that the firms had conflicts of interest because they represented asbestos claimants against Thorpe, but the bankruptcy court approved the employment of the law firms, taking the view that Appellants lacked standing to object. The issue was appealed, the district court remanded for fact-finding, and the bankruptcy court again approved the firms' retention without input from Appellants.

In May 2008, Thorpe, Pacific, the appointed Official Committees of Unsecured Creditors, and the appointed legal representative for holders of future asbestos-related claims ("Appellees") filed a § 524(g) joint plan of reorganization. The current and Fifth Amended Plan of reorganization was filed in December 2009. It is that plan, approved by the bankruptcy court and the district court, that is the subject of this appeal.

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<sup>1</sup>It appears that the policies with Continental and Fireman's fund were exhausted in 1998, and the rest of the insurers contend that their policy limits were exhausted in 2005.

Section 524(g) allows a bankruptcy court to issue sweeping channeling injunctions in Chapter 11 cases involving asbestos claims. § 524(g); 4 COLLIER ON BANKRUPTCY ¶ 524.07. The statute was enacted to adopt the approach taken in the *Johns-Manville* bankruptcy case, wherein a trust (the “*Manville Trust*”) was established together with a series of injunctions to channel asbestos-related claims to the trust. *See Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988). Because of the often lengthy latency period of asbestos-related injuries, the § 524(g) injunction aims to “control the future litigation of all asbestos-related claims against the parties it protects” by preventing “any entity from taking legal action to collect a claim or demand that is to be paid in whole or in part by a trust created through a qualifying plan of reorganization.” COLLIER ON BANK. ¶ 524.07. The injunction may bar actions against the debtor itself as well as claims against the debtor directed at third parties who are directly or indirectly liable—such as where a third party has insured the debtor. *Id.*; § 524(g)(4)(A)(ii). The bankruptcy court may establish such an injunction if it determines that (1) “the debtor is likely to be subject to substantial future demands for payment arising out of” asbestos-related claims; (2) “the actual amounts, numbers, and timing of such future demands cannot be determined”; and (3) “pursuit of such demands outside the [trust] is likely to threaten the [reorganization] plan’s purpose to deal equitably with claims and future demands.” § 524(g)(2)(B)(ii).

The requirements for a § 524(g) injunction include: (1) there must be a notice and a hearing and the 524(g) plan must be in connection with the confirmation of a Chapter 11 plan of reorganization; (2) there must be a trust established to assume the liabilities of the debtor that has been named in asbestos-related actions; (3) the trust must be funded in whole or in part by the securities of at least one debtor and by the obligation of the debtor to make future payments; (4) the trust must own, or be entitled to own, a majority of the voting shares of the debtor, its parent corporation, and any subsid-

iary; (5) the court must find that the debtor meets certain criteria related to the significance of the threats posed by potential asbestos liability; (6) the court must appoint a legal representative to protect the rights of future claimants against the debtor; and (7) the court must determine that the injunction is fair and equitable with respect to future claims (including a determination that third parties like insurers that come within the protection of the injunction have contributed adequate amounts to the trust). § 524(g).

The Fifth Amended Plan filed by Debtors provided for the issuance of injunctions to channel certain asbestos-related liabilities to a newly-created trust, with sole responsibility for distributions to present and future holders of asbestos-related claims. The plan merges Thorpe and Pacific into the “Reorganized Debtor” and discharges Thorpe, Pacific, and the Reorganized Debtor from all debts. It creates a trust, controlled by the Trust Advisory Committee, to oversee how claims are allowed, valued, and distributed. The Trust uses “trust distribution procedures” to evaluate claims.

In establishing the plan and trust, Thorpe reached settlements with thirteen insurers (“settling insurers”) (in addition to four insurers that settled, contingent on a bankruptcy filing, before Thorpe filed). The settlements provided for more than \$600 million in cash and securities to fund the Trust in exchange for releases of claims and protection of 524(g) injunctions. The Debtors contributed the following to the plan: their indemnity claim against the Johns-Manville asbestos trust; the proceeds of the settlements with the Settling Insurers; the “Asbestos Insurance Rights” as defined in the plan; \$500,000 cash; and two promissory notes in the amount of \$1.25 million, secured by 51% of the common stock of Reorganized Debtor. Appellants received from the trust a “Business Loss Allocation;” the trust pays to them a percentage of the money contributed to the trust by the insurance companies up to \$5.25 million.

The plan creates three injunctions. First, the Channeling Injunction bars the assertion of any asbestos-related claim against any protected party and allows for asbestos-related claims only against the trust, the Reorganized Debtor, and non-settling insurers. Second, the Settling Asbestos Insurer Injunction protects settling insurers by preventing the assertion of contribution claims held by non-settling insurers.<sup>2</sup> Instead, the trust absorbs the cost of those barred contributions and reduces dollar-for-dollar any judgment obtained against non-settling insurers holding contribution claims. *Id.* Third, the Asbestos Insurer Injunction prohibits actions against asbestos insurers without permission by the trust; the trust may not allow such actions unless asbestos claimants agree to the same judgment reduction that is binding on the trust before proceeding against non-settling insurers.

The plan contains a valuation matrix. The Matrix gives a way for the trust to value claims consistently across time because of the lengthy latency period of asbestos-related injuries. The value given a claim depends on, *inter alia*, the disease the claimant has, age, work history, and personal history factors.

The plan assigns Debtors' insurance rights to the trust, including policies with the non-settling insurers. The plan contains a section stating that it is "insurance neutral," preserving all "Asbestos Insurance Defenses." However, in apparent contradiction of the neutrality characterization, the plan includes four exceptions to the otherwise preserved defenses. It does not permit a defense:

(a) that is based on the assertion that the transfer of the Asbestos Insurance Rights to the Trust . . . is invalid, unenforceable or otherwise breaches the

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<sup>2</sup>Some non-settling insurers have insurance policies with the settling insurers ("reinsurance"). This injunction prevents the non-settling insurers from filing claims under those policies.

terms of any Asbestos Insurance Policy, Asbestos Insurance Settlement, or any other agreement with any Asbestos Insurer, (b) that has been released, waived, altered or otherwise resolved, in full or in part, in any Asbestos Insurance Settlement, or any other agreement with any Asbestos Insurer, (c) to the extent affected by application of principles of res judicata, collateral estoppel, claim preclusion or issue preclusion, or (d) premised upon the commencement of Chapter 11 Cases under Section 301 of the Bankruptcy Code.

The plan allows claimants either to bring their claim against the trust or to get permission from the trust to sue non-settling insurers directly under Thorpe's insurance policies.

Without giving Appellants the opportunity to be heard fully on all relevant issues, the bankruptcy court affirmed the Fifth Amended Joint Plan of Reorganization on February 1, 2010.

### C

After confirmation of the plan by the bankruptcy court, Appellants appealed the order confirming the Fifth Amended Joint Plan of Reorganization. Under § 524(g), the district court must affirm a plan and its injunctions for them to be valid and enforceable. § 524(g)(3)(A). The district court affirmed the plan, modifying the trust distribution procedures slightly, and entered an order issuing and affirming the plan on September 21, 2010.

Two groups of non-settling insurers appeal the district court decision. These are: (1) Continental Insurance Company and National Fire Insurance Company of Hartford (together, "CNA"); and (2) Motor Vehicle Casualty Company, Central National Insurance Company of Omaha, and Century Indemnity Co. (together, "ACE") (both groups together, "Appellants"). Appellants contend that the courts below erred in their

preemption rulings, that the plan does not comply with § 524(g), that the plan was not proposed in good faith, that the plan was developed by conflicted counsel, and that they have standing to object to the plan and to appeal.

We denied Appellants' emergency motion for a stay pending appeal but consolidated the two appeals and granted expedited briefing. The plan became effective on October 22, 2010, and implementation of the plan began. Appellees filed a motion to dismiss as moot in February 2011, which the motions panel referred to us.

## II. Standard of Review

We have jurisdiction under 28 U.S.C. § 158(d)(1). We review de novo the district court's decision on appeal from the bankruptcy court, applying the same standards applied by the district court, without deference to the district court. *Decker v. Tramiel (In re JTS Corp.)*, 617 F.3d 1102, 1109 (9th Cir. 2010). The bankruptcy court's conclusions of law are reviewed de novo, and its findings of fact are reviewed for clear error. *Id.* The preemption, standing, and insurance neutrality rulings present questions of law reviewed de novo.

## III. Discussion

### A. Mootness

Appellees contend that the appeal is moot because Appellants did not obtain a stay and there has been substantial confirmation of the plan.<sup>3</sup> We will not entertain an appeal if the case is moot. The "party moving for dismissal on mootness grounds bears a heavy burden." *Jacobus v. Alaska*, 338 F.3d

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<sup>3</sup>Appellees' contention on equitable mootness is not asserted within its appellate brief, but was the subject of a separate motion to dismiss the appeal as moot, filed by Appellees, and referred to our panel. For the reasons that follow, we deny the motion to dismiss this appeal as moot.



1095, 1103 (9th Cir. 2003). There are two mootness doctrines to consider—one deriving from Article III of the Constitution, and one from equity. We address these in turn.

[1] The jurisdiction of federal courts is limited to actual cases and controversies. U.S. CONST. art. III, § 2, cl. 2. “The test for mootness of an appeal is whether the appellate court can give the appellant any effective relief in the event that it decides the matter on the merits in his favor. If it can grant such relief, the matter is not moot.” *Felster Publ’g v. Burrell* (*In re Burrell*), 415 F.3d 994, 998 (9th Cir. 2005) (quoting *Garcia v. Lawn*, 805 F.2d 1400, 1402 (9th Cir. 1986)). We conclude that the appeal is not constitutionally moot because we could reverse plan confirmation or require modification of the plan, thereby giving relief to Appellants.

[2] We next address whether this appeal is moot under the doctrine commonly known as “equitable mootness,” which has some sway in bankruptcy cases where public policy values the finality of bankruptcy judgments because debtors, creditors, and third parties are entitled to rely on a final bankruptcy court order. *See, e.g., In re Onouli-Kona Land Co.*, 846 F.2d 1170, 1172 (9th Cir. 1988) (noting the need for finality in bankruptcy); 13B FEDERAL PRACTICE & PROCEDURE § 3533.2.3 (3d ed.) (“Bankruptcy appeals provide numerous examples of the need to protect third party interests arising from substantial implementation of a reorganization plan pending appeal.”). Equitable mootness occurs when a “comprehensive change of circumstances” has occurred so “as to render it inequitable for this court to consider the merits of the appeal.” *In re Roberts Farms*, 652 F.2d 793, 798 (9th Cir. 1981). The question is whether the case “present[s] transactions that are so complex or difficult to unwind that the doctrine of equitable mootness would apply.” *Lowenschuss v. Selnick* (*In re Lowenschuss*), 170 F.3d 923, 933 (9th Cir. 1999). The Second, Third, and Fifth Circuits have developed tests to determine whether an appeal is equitably moot.<sup>4</sup> We

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<sup>4</sup>The Second Circuit has developed a five part test to determine if constitutional and equitable considerations moot an appeal where there has

have not yet expressly articulated a comprehensive test, but our precedents have looked at whether a stay was sought, whether the plan has been substantially consummated, whether third party rights have intervened, and, if so, whether any relief can be provided practically and equitably. *Baker & Drake*, 35 F.3d at 1351 (1994) (“moot if a party opposing a reorganization plan has failed to obtain a stay pending appeal, and the plan has been carried out to ‘substantial [culmination].’ ”); *In re Roberts Farms, Inc.*, 652 F.2d at 797-98 (1981) (moot if plan has been so far implemented that impossible to fashion effective relief or where party challenging

been substantial consummation. “[S]ubstantial consummation will not moot an appeal if all of the following circumstances exist: (a) the court can still order some effective relief; (b) such relief will not affect the re-emergence of the debtor as a revitalized corporate entity; (c) such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court; (d) the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (e) the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order . . . .” *In re Chateaugay Corp.*, 10 F.3d at 952-53 (internal citations and quotations omitted).

The Third Circuit considers the following five factors: “(1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of the parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.” *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir. 2001). The court gives the factors varying weight depending on the particularity of the plan, putting the most weight on whether the plan has been substantially consummated. *Id.*

The Fifth Circuit considers three factors: “(1) whether the complaining party has failed to obtain a stay, (2) whether the plan . . . has been substantially consummated, and (3) whether the relief requested would affect the rights of parties not before the court or the success of the plan.” *TNB Fin., Inc. v. James F. Parker Interests (In re Grimland, Inc.)*, 243 F.3d 228, 231 (5th Cir. 2001).

plan fails to use due diligence to seek a stay); *In re Spirtos*, 992 F.2d at 1006 (1993) (moot if no stay and rights of third parties have intervened, but not if able to fashion relief that is both effective and equitable).

[3] We endorse a test similar to those framed by the circuits that have expressed a standard: We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court. For reasons explained below, we conclude that this appeal is not equitably moot.<sup>5</sup>

[4] First, this is not a case where Appellants sat on their rights; they sought a stay and were refused both by us and by the Circuit Justice. A failure to seek a stay can render an appeal equitably moot. *In re Roberts Farms*, 652 F.2d at 797-98. However, failure to obtain a stay does not require a conclusion of equitable mootness where parties use due diligence in seeking the stay. *In re Lowenschuss*, 170 F.3d at 933 (not equitably moot where sought stay but bankruptcy court refused to grant it). In such a circumstance, where a party has done nothing by its own inaction to encourage or permit developments to proceed without its participation, courts should be cautious about reaching a conclusion of equitable

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<sup>5</sup>We make no determination that Appellants' rights have necessarily been impaired, except in so far as they were not permitted to be heard on the relevant issues in the bankruptcy court, nor that the plan is necessarily deficient. We are remanding so that Appellants can have a full and fair opportunity to present evidence and be heard on those issues before the bankruptcy court.

mootness. To say that a party's claims, although diligently pursued, are equitably moot because of the passage of time, before the party had a chance to present views on appeal, would alter the doctrine to be one of "inequitable mootness." Although practicalities necessarily may take center stage in a particular case, we decline in every case to elevate expediency over the justice of the situation. If Appellants here have presented appellate claims that can be remedied by some reasonable means without totally dislodging the § 524(g) plan, it would be inequitable to dismiss their appeal on equitable mootness grounds merely because the reorganization has proceeded. The failure to gain a stay is one factor to be considered in assessing equitable mootness, but is not necessarily controlling.

[5] Second, we next determine whether substantial consummation of the plan has occurred. The Bankruptcy Code defines substantial consummation as: (a) transfer of all or substantially all of the property proposed by the plan to be transferred; (b) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (c) commencement of distribution under the plan. 11 U.S.C. 1101(2). Here, though distribution under the plan has commenced, all or substantially all of the property the plan proposes to transfer has not been transferred. The plan involves \$600 million in settlement proceeds, and, per the current record, only \$135 million has been transferred to the trust.<sup>6</sup> Further, the trust has only distributed \$44.7 million for pre-petition claims, claims submitted directly to the trust, the Business Loss Allocation, operating expenses, and contingent and professional fees—only \$15 million of this has been to asbestos claimants. This is not half, let alone "substantially all," of the property proposed to be transferred by the plan.

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<sup>6</sup>Appellants object to the declaration offered by Appellees containing this information. We overrule the objection and consider the evidence.

We conclude that the plan has not been substantially consummated.<sup>7</sup>

[6] Third, we must evaluate “whether modification of the plan of reorganization would bear unduly on the innocent.” *In re 203 N. LaSalle St. Pshp.*, 126 F.3d 955, 961 (7th Cir. 1997), judgment rev’d on other grounds, 526 U.S. 434 (1999). An important consideration is whether all the parties affected by the appeal are before the court. *See, e.g., In re Arnold & Baker Farms*, 85 F.3d at 1420; *In re Spirtos*, 992 F.2d at 1007. The plan has proceeded and third party rights have intervened to some extent because the trust has both made and received payments. Appellees argue that any changes made to the plan would be inequitable because asbestos claimants voted on the plan relying on the transactions it created, and any change would unfairly affect the bargain they received. However, in determining whether an appeal is equitably moot, the question is not whether it is possible to alter a plan such that no third party interests are affected, but whether it is possible to do so in a way that does not affect third party interests to such an extent that the change is inequitable. If we followed Appellees’ argument, no party that failed to obtain a stay in § 524(g) cases would ever be able to appeal, because third party rights would always be affected in some way. We reject that position. The Third Circuit has allowed changes to a 524(g) plan where the plan had already been approved by claimants. *Combustion Eng’g*, 391 F.3d at 201-02 (bankruptcy court added super-preemptory provision after approval by majority of asbestos claimants).

[7] Also, the plan provides that it may be modified after confirmation with consent of the trust advisory committee and the Futures Representative but without a vote by asbestos

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<sup>7</sup>If the plan was substantially consummated, that would not be the end of the inquiry. We would agree with our sister circuits, see note 5 *supra*, that we could still assess whether effective relief might be given without fully impairing the prior plan and other pertinent circumstances.

claimants. While the claimants agreed to the plan, they did not agree to a plan that promised no future changes. Further, the appointed Futures Representative is a party to this appeal. The bankruptcy court and the Futures Representative can ensure that any changes to the plan after remand are made in a way that is equitable to all affected parties. Finally, the bankruptcy court could fashion remedies that would not impact the asbestos claimants in a negative way, such as requiring the Debtor to contribute more money to the trust. Appellees argue that the plan is also equitably moot because the reorganized debtor received credit from California Bank & Trust, which creates third party reliance on the plan. But even if the bank extended credit to the reorganized debtor in reliance on the plan, we do not think that remedies short of reversing plan confirmation would affect the bank in an inequitable way.

[8] Fourth, and most importantly, we look to whether the bankruptcy court on remand may be able to devise an equitable remedy. Because traditional equitable remedies are extremely broad and vest great discretion in a court devising a remedy, we expect that if there is violation of Appellants' legal rights from the plan, the bankruptcy court should be able to find a remedy that is appropriate. The plan has thus far proceeded to a point where it may not be viable totally to upset the plan, to tip over the § 524(g) apple cart. Yet, that does not mean that there could not be plan modifications adequate to give remedy for any prior wrong. Where equitable relief, though incomplete, is available, the appeal is not moot. *Paulman v. Gateway Venture Partners III, L.P. (In Re Filtercorp, Inc.)*, 163 F.3d 570, 578 (9th Cir. 1998).

There are several ways here that Appellants could get some relief without completely upsetting the plan. First, Appellees challenge the sufficiency of plan funding. The district court, on appeal, could require Appellees to contribute more to the trust. As an example, the court could require Appellees to return the \$2.5 million they have received pursuant to the Business Loss Allocation. *In re Spirtos*, 992 F.2d at 1007

(“We can fashion effective relief by ordering Debtor, who is a party to this appeal, to return the money to the estate.”); *see also Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1074 (9th Cir. 2002) (finding appeal not equitably moot because remedy was monetary and debtors were solvent). Second, Appellants could receive relief from the bankruptcy court if it amends the plan to make clear that the trust distribution procedures are not binding on direct suits filed against Appellants; because a potentially binding effect is part of what gives the insurers a legally protected interest, *see* section III.B.1, *infra*, a remedy on these lines may be appropriate. *See e.g. Combustion Eng’g*, 391 F.3d at 201-02 (bankruptcy court added super-preemptory provision after approval by majority of asbestos claimants and district court also made changes). Third, the bankruptcy court could allow Appellants to present evidence and argue for modification of the trust distribution procedure. *Varela v. Dynamic Brokers, Inc. (In re Dynamic Brokers, Inc.)*, 293 B.R. 489, 494 (B.A.P. 9th Cir. 2003) (finding appeal not equitably moot where payments were to be made over twenty years and distribution could be adjusted over time). Fourth, the Appellants would receive relief by placing the trust under new governance if the bankruptcy court credits their argument that the trust is in the hands of biased parties.

[9] If abandonment of the § 524(g) plan were the only possible remedy, then there might be equitable mootness. However, we expect that there are many options open to the bankruptcy court other than complete plan reversal that can remedy some of Appellants’ claims if proved valid. Therefore, we hold that this appeal is not equitably moot.

## B. Standing

Two types of standing are at issue: (1) standing to object to the confirmation of the plan in bankruptcy court (“bankruptcy standing”) and (2) standing to appeal that confirmation ruling (“appellate standing”). Appellate standing

requires that a party be directly and adversely affected by the order of the bankruptcy court—that it diminish the appellant’s property, increase its burdens, or detrimentally affect its rights. *Duckor Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.)*, 177 F.3d 774, 777 (9th Cir. 1999). On bankruptcy standing, the interests in a fair plan are paramount, and the bankruptcy court is open to all “parties in interest.” 11 U.S.C. § 1109(b). A party denied standing in the bankruptcy court has appellate standing to challenge that determination. *See, e.g., In re Global Indus. Tech, Inc. (In re GIT)*, 645 F.3d 201, 209 n.23 (3rd Cir. 2011) (en banc). All parties agree that Appellants have appellate standing to appeal the finding of insurance neutrality and to appeal the preemption holding. Because there is no real issue on appellate standing here, we turn to consider bankruptcy standing, and whether the bankruptcy court should have heard Appellants more fully on the issues of concern to them.

[10] To have standing in bankruptcy court, Appellants must meet three requirements: (1) they must meet statutory “party in interest” requirements under § 1109(b) of the bankruptcy code; (2) they must satisfy Article III constitutional requirements; and (3) they must meet federal court prudential standing requirements.

(1)

We first consider whether Appellants had statutory standing under § 1109(b), which provides that:

[a] party in interest, including the debtor, the trustee, a creditors’ committee, an equity security holders’ committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.

§ 1109(b). The “party in interest” standard has generally been construed broadly. *See In re GIT*, 645 F.3d at 210-11 (list not



exclusive); *Kaiser Aerospace & Elec. Corp. v. Teledyne Indus.* (*In re Piper Aircraft Corp.*), 244 F.3d 1289, 1304 n.11 (11th Cir. 2001) (party in interest is defined non-exclusively in § 1109(b)); *Hasso v. Mozsgai* (*In re La Sierra Fin. Servs.*), 290 B.R. 718, 728 (B.A.P. 9th Cir. 2002) (list is nonexclusive); *In re Shoen*, 193 B.R. 302, 311 (Bankr. D. Ariz. 1996) (broad definition); *In re Standard Insulations, Inc.*, 138 B.R. 947, 950 (Bankr. W.D. Mo. 1992) (party in interest not limited to examples listed). “[C]ourts must determine on a case by case basis whether the prospective party has a sufficient stake in the proceedings so as to require representation.” *In re Amatex Corp.*, 755 F.2d 1034, 1042 (3rd Cir. 1985).

[11] The Seventh Circuit determined that § 1109(b) was not intended to provide standing exclusively for the listed examples, but rather was meant to give standing to “anyone who has a legally protected interest that could be affected by a bankruptcy proceeding.” *In re James Wilson Assocs.*, 965 F.2d 160, 169 (7th Cir. 1992). The Third Circuit agreed, finding that the list of potential parties in interest in § 1109(b) is not exclusive and adopting the “legally protected interest” test as a “helpful amplification” of its “sufficient stake in the proceeding[s]” test set out in *In re Amatex*. *In re GIT*, 645 F.3d at 210. Indeed, the Third Circuit noted that Article III standing and standing under the Bankruptcy code were effectively co-extensive. *Id.* at 211.

The bankruptcy court in this case approached the question of standing for Appellants as one of insurance neutrality, an approach taken by other courts. *See, e.g., In re GIT*, 645 F.3d 201; *In re Combustion Eng’g, Inc.*, 391 F.3d 190 (3d Cir. 2004); *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm.*, 321 B.R. 147 (D.N.J. 2005). The bankruptcy court concluded that because the plan was insurance neutral, Appellants had no standing.<sup>8</sup>

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<sup>8</sup>Appellees argue that this case is indistinguishable from *In re Combustion Engineering* where the Third Circuit found that non-settling insurers

[12] Appellants argue that the plan is not insurance neutral because of possible preclusive effects of the plan, because they are responsible for claims channeled to the trust, because the trust permits direct file suits against Appellants, because they are a contingent beneficiary of the trust, and because the plan and trust distribution procedure can be changed without court supervision.<sup>9</sup> We conclude that the plan may economically affect Appellants in substantial ways. A plan is not insurance neutral when it may have a substantial economic impact on insurers.

[13] First, Appellants claim that there is a possibility that the plan will have a preclusive effect in asbestos suits brought against them by claimants. We conclude this claim has merit. Though the plan recites that it is insurance neutral, this characterization in and of itself does not settle the issue. Instead, we must look to the real-world impacts of the plan to see if it increases insurance exposure and likely liabilities of Appellants.

The plan creates four exceptions to Appellants' insurance

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had no standing because the plan was insurance neutral. Even if that case had been adopted as controlling Ninth Circuit precedent, it is distinguishable. *In re Combustion Engineering* was decided in the context of appellate standing and applied the more stringent "person aggrieved" standard, not the "party in interest" standard used in determining whether standing in bankruptcy is appropriate. Further, the plan in *In re Combustion Engineering* was vastly different. There, the plan explicitly preserved all insurance defenses except for the assignment clause in the insurance contracts. Here, the plan contains exceptions to insurance defenses that go beyond the anti-assignment clause exception. Thus, the standard in *In re Combustion Engineering* was different, as was the plan.

<sup>9</sup>Appellants also argue that they had standing because of the preemption of their anti-assignment state rights. Appellants had standing on that issue. Further, assignment of the insurance contracts to the trust does not provide standing to challenge anything other than preemption as long as all other rights are preserved. *Combustion Eng'g*, 391 F.3d at 216. Preemption of anti-assignment clauses do not, alone, destroy the insurance neutrality of the plan.

defenses. One such exception is that insurance defenses are not preserved “to the extent affected by application of principles of res judicata, collateral estoppel, claim preclusion or issue preclusion.” The bankruptcy court held that the plan was insurance neutral, but, at the same time, it held that “the Debtors’ insurers may or may not be bound by the Trust’s resolution of its claimed liability on an Asbestos Related Claim.” The bankruptcy court further provided that “[w]hether and to what extent the values generated by the Internal Procedures will bind a particular Non-Settling Asbestos Insurer will be resolved in the Coverage Litigation.”<sup>10</sup>

[14] These conclusions appear to be contradictory, or at least in serious tension with each other. If the Appellants *may* be bound by the Trust’s determination of an amount of liability on an asbestos claim, it would be hard to see how that would not have a real impact on the appellant insurance companies. If the actual amount of payments due from insurance companies is increased by the plan from what those liabilities would be absent the plan, then the plan has monetary impact in the real world of insurance, and is not insurance neutral. Here Appellants reasonably complain that they were not permitted to participate in establishing the valuation matrix. That would be no problem if they could challenge amounts set by it, but it is a problem for them if they may be bound by it without prior participation.

[15] The language in the plan and in the bankruptcy court’s order is different from the “super-preemptory” language contained in the plan in *In re Combustion Engineering*, where the court determined the plan had no impact on insurers. There, the plan stated:

Notwithstanding anything to the contrary in this

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<sup>10</sup>The Coverage Litigation are cases in California state court in which some non-settling insurers and Thorpe are litigating the extent of coverage provided by the insurance policies.

Order, the Plan or any of the Plan Documents, nothing in this Order, the Plan or any of the Plan documents (including any other provision that purports to be preemptory or supervening), shall in anyway [sic] operate to, or have the effect of, impairing the insurers' legal, equitable or contractual rights, if any, in any respect.

*In re Combustion Eng'g*, 391 F.3d at 209. Even if there is a super-preemptory provision, "care must be taken to ensure that, in fact, the insurer's rights are completely unaffected. If the insurer's rights are affected in any way, the insurer will have standing to object to the alteration of its rights." COLLIER ON BANK. ¶ 1109.04. Here, the express exceptions to Appellants' defenses signal that the plan is not insurance neutral.

Second, Appellants must indemnify payments made by the trust pursuant to settlements with asbestos claimants. Without participation by Appellants, the trust determines how much to pay to the claimants and then may seek payment from Appellants. For the same reasons discussed above, the plan would not necessarily permit the insurers to challenge settlement amounts as unreasonable.

Third, under the plan, the trust can allow asbestos claimants to file direct suits against Appellants. "As a general matter, . . . parties with potential responsibility to pay claims against debtors regularly have standing to participate in bankruptcy cases." *Baron & Budd*, 321 B.R. at 158. For this reason, each of the insurers who may be sued directly and may be liable to claimants should be viewed as a party in interest to the proceedings establishing the trust. Moreover, if the trust runs out of money because it is insufficiently funded or because the trust distribution procedures are insufficiently stringent, the likelihood of claims being brought against the non-settling insurers increases. If the trust runs out of money, the channeling injunctions will preclude claimants from seeking damages

from any other insurers than the non-settling insurers. This would have a substantial economic impact on Appellants.

Fourth, the plan may have economic consequences for Appellants by affecting their reinsurance with settling insurers. Because the injunction protects the settling insurers, Appellants' only recourse for any contribution, subrogation, or indemnification resulting from reinsurance is against the trust making them beneficiaries. The order confirming the plan states that the trust may not permit a direct claim against a non-settling insurer unless the claimant agrees in writing to reduce the judgment by the amount the settling insurer owes to Appellants. The order further provides that in direct action litigation, if the non-settling insurer is found to have a claim against a settling insurer for litigation costs, and they are unable to recover those costs through a judgment reduction, then the non-settling insurer can bring an action against the Trust for that amount. If the Trust runs out of money because it is insufficiently funded, then any costs that Appellants could have recovered against it will be lost. The right to recover costs is a right provided for by a contract negotiated between the settling insurer and the non-settling insurer. This right is a legally protected right. Any inadequacy in the trust threatens to diminish the value of Appellants' claims. Therefore, the insurers' allegations that the plan does not comply with the funding requirements of § 524(g) are sufficient to establish standing.

[16] In summary, the plan allows direct actions against Appellants. It allows the trust to pay out claims according to the trust distribution plan and then to seek indemnification from Appellants. It terminates Appellants' ability to collect claims from settling insurers. It affects the nature of Appellants' contracts with Appellees. Though § 524(g) contemplates this kind of interference with insurers' contracts, there is no doubt that the vast changes to the insurance policies and relationships have the potential substantially to impact Appellants economically. The plan is therefore not insurance neu-

tral, which provides the non-settling insurers with party in interest standing under § 1109(b). We hold that appellants had bankruptcy standing and should have been permitted to be heard in challenging the plan, if they had Article III standing and satisfied prudential standing requirements.

(2)

Having found that Appellants are parties in interest under § 1109(b), we consider whether they also satisfy the requirements of Article III standing. To have constitutional standing under Article III, the party seeking standing must demonstrate an injury in fact that is traceable to the challenged action and that is likely to be redressed by a favorable decision. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992). As applied in the Chapter 11 context, Article III standing exists where “the participant holds a financial stake in the outcome of the proceeding such that the participant has an appropriate incentive to participate in an adversarial form to protect his or her interests.” COLLIER ON BANK. ¶ 1109.04; *see also United States v. 5208 Los Franciscos Way*, 385 F.3d 1187, 1191 (9th Cir. 2004).

[17] Appellants had Article III standing. As discussed above, the plan affects Appellants’ contractual rights, affects their financial interests, and has the possibility of affecting their litigation rights in court. The plan potentially increases the liabilities of the insurance companies with real world economic impact, and, as such, Appellants have sufficiently alleged an injury in fact. This injury is traceable to the plan. It is only because of the plan that Appellants’ contractual rights and expectations were changed. This injury would be redressed by judicial action, such as if the bankruptcy or district court reversed confirmation of the plan or altered the plan to make it insurance neutral. All three required elements of the *Lujan* test are satisfied, and Appellants have Article III standing.

## (3)

“In addition to the immutable requirements of Article III, ‘the federal judiciary has also adhered to a set of prudential principles that bear on the question of standing.’ ” *Bennett v. Spear*, 520 U.S. 154, 162 (1997) (quoting *Valley Forge Christian Coll. v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 474-475 (1982)). This prudential principle is a “judicially self-imposed limit[ ] on the exercise of federal jurisdiction.” *Allen v. Wright*, 468 U.S. 737, 751 (1984). It is “founded in concern about the proper—and properly limited—role of the courts in a democratic society.” *Warth v. Selden*, 422 U.S. 490, 498 (1975). One of these prudential requirements is that “[a] plaintiff’s grievance must arguably fall within the zone of interests protected or regulated by the statutory provision or constitutional guarantee invoked in the suit.” *Bennett*, 520 U.S. at 162. “The ‘zone of interests’ requirement is analogous to ‘statutory standing.’ ” *In re Chiu*, 266 B.R. 743, 749 (B.A.P. 9th Cir. 2001) (quoting *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 669 n.13 (7th Cir. 1998)). “[T]he predecessor provisions of section 1109(b) of the Code, constituted an effort to encourage and promote greater participation in reorganization cases. . . . Section 1109(b) continues in this tradition and should be understood in the same way.” *In re Amatex*, 755 F.2d at 1042; *see also* 7 COLLIER ON BANK. ¶ 1109.04[2][b] (“A fundamental purpose of section 1109(b) is to grant any party with a financial stake in the case the right, at the party’s election, to participate with respect to the judicial determination of any issue bearing on the ultimate disposition of his or her interest.”).

[18] Appellants have § 1109(b) standing, or bankruptcy standing. Also, as insurers of the Debtors, they were within the “zone of interests” protected or regulated by the statutory provision. Congress intended § 1109(b) to confer broad standing so that those whose rights would be affected by reorganization proceedings could participate and protect their rights.

## (4)

[19] Having determined that Appellants met statutory (“party in interest”), constitutional (*Lujan* Article III test), and prudential (“zone of interests”) standing requirements, we next consider the extent of their standing in bankruptcy court. Section 1128(b) states that “[a] party in interest may object to the confirmation of a plan.” § 1128(b). Because Appellants are parties in interest, they should have had standing to object to confirmation of the plan. *In re GIT*, 645 F.3d at 211 (“Status as a party in interest is of particular relevance here because the Bankruptcy Code expressly provides that parties in interest ‘may object to confirmation of a plan.’ ”); *see also* COLLIER ON BANK. ¶ 1109.04[2][a] (“[E]very court would seem to agree that section 1109(b) applies in full force to a plan confirmation proceeding given the momentous nature of this proceeding in most cases.”). For this reason the non-settling insurers had a right to be heard, to present evidence, and to participate in the proceedings culminating in approval of the § 524(g) plan.

### C. Preemption

Appellants also appeal the district court’s determination that their anti-assignment contract rights were preempted by state law. The plan assigns Thorpe’s insurance rights to the trust and excludes from Appellants’ defenses any defense based upon violation of the anti-assignment clauses. However, the policies under which Thorpe is insured contain language requiring Appellants’ consent before an assignment or transfer of policy rights. Under California law, assignment of insurance benefits may violate an anti-assignment provision if the claim against the policy has not been “reduced to a sum of money due or to become due under the policy.” *Henkel Corp. v. Hartford Accident and Indemnity Co.*, 29 Cal. 4th 934, 944 (2003). The bankruptcy and district courts determined that bankruptcy law preempted the anti-assignment clauses in the insurance policies.



“We must be cautious about conflict preemption where a federal statute is urged to conflict with state law regulations within the traditional scope of the state’s police powers,” and we begin with a “presumption against preemption.” *Chae v. SLM Corp.*, 593 F.3d 936, 944 (9th Cir. 2010). But, “[i]t is a familiar and well-established principle that the Supremacy Clause . . . invalidates state laws that ‘interfere with, or are contrary to,’ federal law.” *Hillsborough Cnty. v. Automated Med. Laboratories, Inc.*, 471 U.S. 707, 712 (1985). In determining whether preemption exists, “[t]he purpose of Congress is the ultimate touchstone . . . .” *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996).

Preemption can occur either expressly or impliedly. “Express and implied preemption under the Bankruptcy Code are two distinct concepts.” *PG&E Co., v. Cal. ex rel. Cal. Dep’t of Toxic Substances Control*, 350 F.3d 932, 948 (9th Cir. 2003). “Congress may indicate pre-emptive intent through a statute’s express language or through its structure and purpose.” *Altria Group, Inc. v. Good*, 129 S. Ct. 538, 543 (2008). In the absence of express preemption, Congressional intent can be inferred where “it is impossible for a private party to comply with both state and federal requirements, . . . or where state law ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’ ” *Crosby v. Nat’l Foreign Trade Council*, 530 U.S. 363, 372-73 (2000) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

(1)

[20] Here Congress has expressly preempted Appellants’ contract rights. Section 541(c) provides that “an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law . . . that restricts or conditions transfer of such interest by the debtor . . . .” 11 U.S.C. § 541(c)(A). In *In re Combustion Engineering*, the Third Circuit held that the Bankruptcy Code “expressly contemplates

the inclusion of debtor insurance policies in the bankruptcy estate.” *In re Combustion Eng’g*, 391 F.3d at 219 n.27. The court held that § 541 “effectively preempts any contractual provision that purports to limit or restrict the rights of a debtor to transfer or assigns [sic] its interest in bankruptcy.” *Id.*; see also *In re Kaiser Aluminum Corp.*, 343 B.R. 88, 95 (D. Del. 2006) (541(c) expressly preempts anti-assignment clauses).

Appellants argue that precedent precludes a finding that 541(c)(1)(A) preempts the contract provisions. They point to *In re Farmers Markets* and argue that § 541(c) does not preempt state laws that put limitations on transfers of property to third parties. *In re Farmers Markets, Inc.*, 792 F.2d 1400, 1402 (9th Cir. 1986). That case involved the question of whether § 541(c) preempted a state law that disallowed the transfer of a liquor license until the holder paid certain state taxes. *Id.* at 1401. There, the court held that § 541(c) does not invalidate all transfer restrictions on property in which the debtor holds an interest, but “avoids only those restrictions which prevent transfer of the debtor’s property to the estate.” *Id.* at 1402. Therefore, the state could require the estate to pay the taxes before allowing the transfer of the license to a third party. *Id.* at 1404. Here, however, the trust is not a third party. The order confirming the plan provides that the trust is appointed as the estate representative. The trust is part of the debtor’s estate. Instead of attempting to sell or assign anything to third parties, the debtor was attempting to transfer its rights and property to the trust, part of the estate. Accordingly, *In re Farmers Markets* does not preclude a finding that 541(c) preempts Appellants’ anti-assignment contract rights.

Appellants also argue that in *PG&E* we held that a reorganization plan may preempt nonbankruptcy law “only to the extent that such law ‘relates to financial condition.’ ” *PG&E*, 350 F.3d at 937. They argue that since Appellants’ rights do not relate to a “financial condition” preemption is not appropriate here. In *PG&E* we dealt only with §§ 1123(a) and 1142(a), and issues of express preemption by those provi-

sions, and did not interpret § 541(c) as we do here. *PG&E* is not applicable to the preemption issue in this case, as it doesn't tell us whether the anti-assignment clauses in the contracts between insurers and the debtors are preempted by § 541(c).

(2)

Even if 541(c) did not expressly preempt the anti-assignment provisions, this would not end the inquiry because “[i]t is possible for there to be no express preemption under a particular provision of the Bankruptcy Code, but nonetheless to be implied preemption under the Code.” *PG&E*, 350 F.3d at 948. “Even where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law.” *Hillsborough Cnty.*, 471 U.S. at 713. “We discern congressional objectives by ‘examining the federal statute as a whole and identifying its purpose and intended effects.’ ” *Chae*, 593 F.3d at 943 (quoting *Crosby*, 530 U.S. at 373).

[21] Here, enforcing the anti-assignment clauses would stand as “an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>11</sup> *English v. Gen. Elec. Co.*, 496 U.S. at 79 (quoting *Hines*, 312 U.S. at 67). As the district court noted, *Henkel* would bar any company with significant insurance contracts governed by California law from taking advantage of 524(g). For a plan to be approved, the trust must be sufficiently funded. As here, companies usually can do so only by settling with insurers and putting those funds in the trust. Yet, if we enforced the anti-assignment provisions, it would be to the detriment of the

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<sup>11</sup>Appellants argue primarily that enforcing the anti-assignment provisions does not make it impossible to reorganize. Even if we accept Appellants' premise, this does not wholly resolve preemption. Instead, we must assess whether the anti-assignment provisions stand as an obstacle to the objectives of Congress. See *Crosby*, 530 U.S. 363; *Chae*, 593 F.3d 936.

potential efficacy of a § 524(g) plan. After a debtor had filed for bankruptcy, no insurer would settle, with the aim of funding a § 524(g) plan, because by refusing to settle, the insurer could position itself to claim forfeiture of the insurance if a plan proceeded and there was a consequent breach of the anti-assignment provisions. “Simply making a reorganization more difficult for a particular debtor, however, does not rise to the level of ‘standing as an obstacle to the accomplishment of the full purposes and objectives of Congress.’ ” *In re Baker & Drake, Inc.*, 35 F.3d at 1354 (quoting *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300 (1988)). This is not the case here, because enforcing the anti-assignment provisions would subject virtually all § 524(g) reorganizations to an insurer veto.

[22] We are unconvinced by Appellants’ argument that Appellees are merely allowed to reorganize under § 524(g) but not entitled to do so and accordingly preemption is not appropriate. Section 524(g) was specifically designed to allow companies with large asbestos-related liabilities to use Chapter 11 to transfer those liabilities, along with substantial assets, to a trust responsible for paying future asbestos claims. *See* H.R. Rep. No. 103-835, at 46-47 (1994). It requires that a trust be established that assumes the debtor’s asbestos liabilities. § 524(g)(2)(B)(I). Part of the “cornerstone” of the reorganization is contribution by the insurers to the trust. *Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195, 2199 (2009). For such reasons we hold that the anti-assignment provisions contained in the contracts between Appellants and Appellees stand as an obstacle to completion of a successful § 524(g) plan, and therefore are preempted by federal bankruptcy law.

#### IV. Conclusion

We reject Appellees’ argument that this appeal should be dismissed as “equitably moot.” Although the plan has proceeded to a point where it may be inequitable to toss it out entirely, we also conclude that there are likely viable remedies

available to Appellants, short of entirely tossing the plan out, within the broad remedial discretion of the bankruptcy court, if it determines that Appellants' claims (discussed in footnote one) have merit.

The bankruptcy court and district court erred by concluding that the proposed § 524(g) plan was insurance neutral and that Appellant insurers did not have party in interest standing to challenge the plan. Because the plan had likely effects that would increase economic exposure of the insurer Appellants to asbestos claimants, they had a right to be heard fully and fairly before the plan was finalized. Also, we affirm the bankruptcy court's and district court's conclusions that the anti-assignment clauses in the contracts between insurers and the Debtor were preempted by federal law.

[23] There is no entirely tidy way to resolve this case because the plan has proceeded without stay and without full input from insurer parties who will be economically affected by the plan. But we have concluded that the starting place is for us to reverse the judgment of the district court, and to remand to the district court with instructions that it remand to the bankruptcy court to permit Appellants to submit their proof on all issues they previously preserved.

**REVERSED AND REMANDED with instructions.**

**PROOF OF SERVICE**

I declare that I am over the age of eighteen (18) and not a party to this action. My business address is 1999 Avenue of the Stars, 39th Floor, Los Angeles, California 90067.

On February 7, 2012, I caused to be served the following document:

**APPELLEES' PETITION FOR REHEARING *EN BANC***

on the interested parties in this action by placing a true and correct copy of document in a sealed envelope addressed as follows:

**PLEASE SEE ATTACHED SERVICE LIST**

- ( ) [U.S. MAIL] I am readily familiar with the business practice for collection and processing of correspondence for mailing with the United States Postal Service. I know that the correspondence is deposited with the United States Postal Service on the same day this declaration was executed in the ordinary course of business. I know that the envelope was sealed and, with postage thereon fully prepaid, placed for collection and mailing on this date, following ordinary business practices in the United States mailed at Los Angeles, California. I am aware that on motion of a party served, service is presumed invalid if the postal cancellation date or postage meter date on the envelope is more than one day after the date of deposit for mailing contained in this affidavit.
- ( ) [FACSIMILE] I caused the above-named document(s) to be transmitted by facsimile transmission on this date to the person(s) and facsimile number(s) shown above following ordinary business practices in the United States at Los Angeles, California. The transmission was reported as complete without error and a transmission report was properly issued by the transmitting facsimile machine whose number is (310) 407-9090.
- ( ) [OVERNIGHT DELIVERY] Via Federal Express or similar overnight courier service, by depositing in a box or other facility regularly maintained by such overnight delivery service, or delivering such envelope receive documents, in an envelope designated by said overnight delivery service with delivery fees paid or provided for, addressed to the address last shown by that person on any documents filed in this action.
- ( X ) [ELECTRONIC MAIL] I caused the above-named document(s) to be transmitted by electronic mail on this date to the person(s) shown above following ordinary business practices in the United States at Los Angeles, California.

Executed on February 7, 2012, at Los Angeles, California.

- ( X ) (FEDERAL) I declare that I am admitted to practice before this court.

  
\_\_\_\_\_  
David M. Guess

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