

## LexisNexis® Emerging Issues Analysis

*Jennifer Black Strutt on***In re: Federal-Mogul Global Inc.: Third Circuit Holds Bankruptcy Code Preempts Anti-Assignment Provisions, Allowing Transfer of Policy Rights to Asbestos Trust**

2012 Emerging Issues 6713

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Federal-Mogul Global, Inc., one of the world's largest manufacturers of automobile parts, and over 150 affiliates (collectively "Federal-Mogul"), filed for Chapter 11 bankruptcy as a result of asbestos-related liabilities.<sup>1</sup> At the time Federal-Mogul petitioned for bankruptcy, it was alleged that Federal-Mogul expended over \$350 million in the preceding year in defense and indemnity costs and 500,000 asbestos claims were still pending.<sup>2</sup> Federal-Mogul's proposed plan for reorganization sought to channel present and future asbestos-related claims to a trust pursuant to [11 U.S.C. § 524\(g\)](#).<sup>3</sup> Additionally, the plan assigned assets to the trust, including Federal-Mogul's rights to recover under liability insurance.<sup>4</sup> The plan included provisions granting insurers the right to assert any defenses to coverage already available under the policies, except for the defense that the transfer of the policies to the trust violated any anti-assignment provisions – i.e., standard clauses that bar the insured from transferring the policies without the insurers' consent.<sup>5</sup>

The insurers objected to the plan on the basis that a transfer to the trust would violate the insurance policies' anti-assignment provisions.<sup>6</sup> Federal-Mogul countered that the anti-assignment provisions were preempted under the Bankruptcy Code, [11 U.S.C. § 1123\(a\)\(5\)\(B\)](#).<sup>7</sup> The bankruptcy court agreed with Federal-Mogul and confirmed the plan.<sup>8</sup> The district court affirmed and this appeal to the Third Circuit ensued.<sup>9</sup>

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1. *In re: Federal-Mogul Global, Inc.*, 684 F.3d 355, 2012 U.S. App. LEXIS 8814, at \*22 (3d Cir. 2012).

2. *Id.*

3. *Id.* at \*23.

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.* at \*23-\*24 (citing [11 U.S.C. § 1123\(a\)\(5\)\(B\)](#)).

8. *Id.* at \*24.

9. *Id.* at \*24, \*27.

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The court first addressed the importance of the Bankruptcy Code with regard to the resolution of mass tort liability.<sup>10</sup> Specifically, the court noted that Chapter 11 bankruptcies have employed the statutory mechanism created by [11 U.S.C. § 524\(g\)](#) to evaluate asbestos claims and allocate payments to current and future claimants.<sup>11</sup> In practice, when the provisions of such statute are satisfied, “the bankruptcy court may issue an injunction channeling all current and future claims based on the debtor’s asbestos liability to a personal injury trust.”<sup>12</sup> Thus, the Bankruptcy Code “permits a global resolution and discharge of current and future liability, while claimants’ interests are protected by the bankruptcy court’s power to use future earnings to compensate similarly situated tort claimants equitably.”<sup>13</sup> The court noted that an asbestos personal injury trust receives funding from three sources – “debtor cash, debtor stock, and insurance settlements.”<sup>14</sup>

The court acknowledged two “foundational principles of preemption jurisprudence” – (1) the purpose of Congress is primarily discerned from the language of the preemption statute, the statutory framework surrounding it, and the structure and purpose of the statute; and (2) there is a presumption against preemption.<sup>15</sup> The court rejected the insurers’ suggestion that this disputed issue was one of first impression, citing *In re: Combustion Engineering, Inc.*, in which the court concluded that “any objection to the reorganization plan based on the anti-assignment provisions could be overcome through a combination of § 541 and § 1123.”<sup>16</sup>

The court considered the text of § 1123, which establishes the contents of a plan for reorganization under Chapter 11, and which provides (in part) as follows:

“(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall –

. . .

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10. *Id.* at \*4.

11. *Id.*

12. *Id.*

13. *Id.* at \*9.

14. *Id.* at \*13.

15. *Id.* at \*28-\*29 (citations omitted).

16. *Id.* at \*33 (citing *In re: Combustion Engineering, Inc.*, 391 F.3d 190, 219 n.27 (3d Cir. 2004)).

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“(5) provide adequate means for the plan’s implementation, such as –

...

“(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan.”<sup>17</sup>

The court noted other cases in which the Third Circuit “cited § 1123(a) as an instance where Congress used ‘explicit language’ to demonstrate its intent ‘to displace state nonbankruptcy law,’”<sup>18</sup> and in which other federal circuit courts determined the “notwithstanding” clause expressly preempted state law.<sup>19</sup>

The court’s conclusion that § 1123(a) preempts state law did not end its inquiry, however, because the court was required to “identify the domain expressly preempted.”<sup>20</sup> The insurers offered several limiting principles in support of their argument that the preemptive scope did not reach the transfer of insurance rights.<sup>21</sup> First, the insurers argued that the “notwithstanding” clause did not apply to all subsections of the statute, but the court disagreed.<sup>22</sup> The court also rejected an insurer’s argument that “otherwise applicable nonbankruptcy law” did not encompass private contracts (including the insurance policies at issue).<sup>23</sup> Furthermore, the court noted that the “notwithstanding” clause in § 1123(a) was limited to “nonbankruptcy law” and did not conflict with other provisions of the Bankruptcy Code.<sup>24</sup>

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17. *Id.* at \*37 (citing 11 U.S.C. § 1123(a)(5)(B)).

18. *Id.* at \*41 (citing *Integrated Solutions, Inc. v. Service Support Specialties*, 124 F.3d 487, 493 (3d Cir. 1997)).

19. *Id.* (citing *PG&E Co. v. Cal.*, 350 F.3d 932, 946 (9th Cir. 2003), and *In re: FCX, Inc.*, 853 F.2d 1149, 1154-55 (4th Cir. 1988)).

20. *Id.* (internal citation omitted).

21. *Id.* at \*42.

22. *Id.* at \*43-\*44.

23. *Id.* at \*45-\*46.

24. *Id.* at \*48.

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Thus, the court found that the “plain language of § 1123(a) evince[d] clear congressional intent for a preemptive scope that include[d] the transactions listed under § 1123(a)(5) as ‘adequate means’ for the plan’s implementation, including the transfer of property authorized by (a)(5)(B).”<sup>25</sup> Moreover, the court found “[t]he plain language also reache[d] private contracts enforced by state common law, and [overcame] the presumption against preemption.”<sup>26</sup> As a result, the preemption provision was broad enough to encompass the anti-assignment provisions of insurance policies that purported to bar transfer to a personal injury trust established under § 524(g).<sup>27</sup>

The insurers argued that a narrow reading of § 1123(a) was supported by prior practice and legislative history.<sup>28</sup> Such argument, however, was contradicted by the existing law at the time the “notwithstanding” clause was added to § 1123(a).<sup>29</sup> Specifically, the existing Bankruptcy Code included preemptive language in another section that allowed the implementation of a plan notwithstanding some nonbankruptcy laws. In addition, case law from that period held that § 1123 preempted state law.<sup>30</sup> In sum, the court declined to rely on prior practice or the “thin and vague legislative history” that said “nearly nothing about the intended preemptive scope of § 1123(a).”<sup>31</sup> The court found that the unambiguous language of the Code indicated a congressional intent to preempt non-bankruptcy state and federal law.<sup>32</sup>

Finally, the court reasoned that preemption in this instance furthered the purpose of the Bankruptcy Code, which was to “prevent creditors and others from employing a debtor’s bankruptcy filing to diminish post-filing contractual rights.”<sup>33</sup> The court found that preemption furthered the purpose of a § 524(g) trust because the anti-assignment provisions

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25. *Id.* at \*58.

26. *Id.*

27. *Id.*

28. *Id.* at \*59.

29. *Id.* at \*64.

30. *Id.* at \*64-\*65.

31. *Id.* at \*66-\*67.

32. *Id.* at \*68.

33. *Id.* at \*70-\*71.

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would deprive debtors and claimants access to assets that were intended to compensate potential losses.<sup>34</sup> The insurers argued that transfer to the trust would increase their exposure, but the court doubted asbestos-based liabilities that were based on events that already occurred and for which the insurers were already potentially responsible shifted the insurers' liability.<sup>35</sup> Furthermore, the court rejected as "speculation" the insurers' suggestion that transfer of the policies to the trust would encourage the debtor to collude with claimants and impose costs on the insurers, pointing out that Congress codified "exceptional precautions" at every stage of the bankruptcy proceeding.<sup>36</sup>

In sum, the court held that the "anti-assignment provisions in the relevant insurance policies [were] preempted by § 1123(a)(5)(B) to the extent they prohibit transfer to a § 524(g) trust."<sup>37</sup>

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34. *Id.* at \*72.

35. *Id.* at \*73.

36. *Id.* at \*77-\*78 (internal citation omitted).

37. *Id.* at \*83.

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