SUPREME COURT PRECLUDES COLLATERAL ATTACK ON BANKRUPTCY COURT ORDERS IN *TRAVELERS INDEMNITY CO. v. BAILEY*

On June 18, 2009, the Supreme Court of the United States issued a 7-2 decision in *Travelers Indemnity Co. v. Bailey,* No. 08-295. The case reinforces the binding nature and effect of a final bankruptcy court order, even where the court may have lacked jurisdiction to enter that order in the first place.

I. FACTS AND PROCEDURAL HISTORY

The decision stems from the Johns-Manville bankruptcy cases. The company filed for bankruptcy protection in 1982 as a result of massive asbestos-related liabilities. Its 1986 plan of reorganization incorporated a global settlement that enjoined certain lawsuits against its insurers, including Travelers, and established a channeling trust for addressing asbestos claims. Manville's insurers provided most of the funding of that trust, including $80 million from Travelers. The bankruptcy court order approving the settlement provided that the settling insurance companies would be released from all "Policy Claims," defined to include all claims and liabilities "(whether or not presently known) which have been, or could have been, or might be, asserted by any Person against ... any or all members of the Settling Insurer Group based upon, arising out of or relating to any or all of the Policies."

Years after the confirmation of Manville's plan, numerous plaintiffs began filing actions against Travelers in state courts, asserting direct actions under state consumer-protection statutes and under common law, alleging that Travelers conspired with other insurers and asbestos manufacturers to hide, and otherwise fail to warn about, the dangers of asbestos. Thus, many of the plaintiffs' asserted claims were based on Travelers' own alleged misconduct, and were not merely indirect claims stemming from Manville's conduct.

In defending against these claims, Travelers sought a restraining order from the bankruptcy court that had issued the 1986 confirmation and settlement orders, contending that those orders expressly precluded the plaintiffs' suits. Travelers ultimately reached a further settlement with three sets of the state law plaintiffs, agreeing to pay an additional $400 million, contingent upon the entry of a new "clarifying" order of the bankruptcy court finding that the direct actions asserted by these plaintiffs against Travelers were also enjoined by the 1986 confirmation and settlement orders. The bankruptcy court ultimately entered such a clarifying order in 2004, after determining that because any knowledge Travelers may have had about the dangers of asbestos was derived from its long-standing insurance relationship with Manville, any claims against Travelers were "related to" the insurance policies, and were thus of the type of claims that were permanently barred as part of the 1986 plan confirmation and settlement.

Certain of the individual claimants and Chubb Indemnity Insurance Company appealed the entry of the clarifying order. Chubb was a co-defendant with Travelers in certain of the direct actions, and the clarifying order prevented Chubb from bringing contribution and indemnity claims against Travelers under certain circumstances. After the district court affirmed the bankruptcy court order, the United States Court of Appeals for the Second Circuit reversed, ruling that although the bankruptcy court had the authority to interpret and clarify its own orders, it could not enjoin claims over which it had no jurisdiction. The Court of Appeals held that because the plaintiffs' direct claims against Travelers did not seek to collect on the basis of Manville's actions, but only sought to recover against the non-debtor insurance companies for their own actions, the bankruptcy court lacked jurisdiction to enjoin those claims, as they would not directly affect the *res* of Manville's bankruptcy estate.

II. SUPREME COURT'S DECISION

The Supreme Court reversed, holding that the terms of the bankruptcy court's 1986 orders were final and controlling, even if the bankruptcy court may potentially have acted beyond the scope of its jurisdiction when it first entered those orders. Because the direct claims being asserted against Travelers did fall within the type of claims that the (long final) 1986 orders expressly enjoined, and the bankruptcy court always had jurisdiction to interpret its own prior orders, the bankruptcy court had the authority to enter the 2004 clarifying order. The Supreme Court expressly stated that whether or not the bankruptcy court initially had jurisdiction to enter the injunction in 1986 was not before the Court now, and could not be collaterally attacked. As long as the plaintiffs and those in privity with them were given a fair chance to challenge the 1986 orders and the bankruptcy court's jurisdiction to enter them at that time, such parties could not now appropriately challenge those orders.

From an insurance standpoint, the Supreme Court's interpretation of the term "Policy Claims" (in the 1986 orders) as including claims against the insurer for its own conduct where the conduct is based on information derived from a longstanding, overall relationship with an insured, is potentially problematic. The dissent certainly thought so: Justice Stevens thought the interpretation to be beyond both the bankruptcy court's power and the parties' shared expectations in 1986. Whether the broad interpretation will ultimately benefit insurers or policyholders is perhaps a moot point; that it should induce additional care in negotiating the scope of releases in settlement of coverage litigation is clear.

From a bankruptcy standpoint, the Supreme Court did emphasize that its holding was "narrow," and it chose not to resolve whether the bankruptcy court had the power to enjoin claims against non-debtor insurers that were not necessarily derivative of the debtor's wrongdoing. Indeed, the Court questioned whether such an injunction could be issued today, in light of the 1994 addition of Section 524(g) of the Bankruptcy Code, which, among other things, specifically authorizes bankruptcy courts to enjoin actions against non-debtor asbestos insurers and to channel such claims to a trust under certain circumstances. "On direct review today," an injunction such as the one the *Manville* court approved in 1986 "would have to be measured against the requirements of § 524 (to begin with, at least). But owing to the posture of this litigation, we do not address the scope of an injunction authorized by that section."

III. SIGNIFICANCE OF THE DECISION

The *Travelers* decision is notable for two reasons. First, it reaffirms the Court's position, set forth in the historic case of *Stoll v. Gottlieb*, 305 U.S. 165 (1938), which the *Travelers* court cited, regarding the importance of preserving the finality of court orders in the bankruptcy context. This actually represented a policy choice by the Court, since it could instead have followed *Kalb v. Feuerstein*, 308 U.S. 433 (1940), which post-dated *Stoll* and is generally perceived as having been a results-oriented trip in the wrong direction. From the standpoint of the federal common law of *res judicata*, the significance of *Travelers* lies in its general agreement with the analysis of section 12 of the *Restatement (Second) of Judgments* on this issue, which perhaps portends further resort to the *Restatement* on other issues of scope and enforcement of federal judgments.

From a prospective bankruptcy standpoint, the emphasis in *Travelers* that the decision there was "narrow" suggests that bankruptcy courts may in the future be limited under Section 524(g) in their ability to release and enjoin, as part of a channeling trust, any direct, non-derivative claims against asbestos insurers, which may potentially impair, at least in part, a debtor's ability to establish the type of global settlement that helped to successfully resolve the *Manville* case two decades ago, and has served as a model (now codified) for other similar asbestos-based channeling injunctions.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Edward P. Krugman at 212.701.3506 or ekrugman@cahill.com; Joel H. Levitin at 212.701.3770 or jlevitin@cahill.com; or Stephen J. Gordon at 212.701.3454 or sgordon@cahill.com.