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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re:	)	
	)	Case No. 04-08822-PCW-11
	)	
THE CATHOLIC BISHOP OF SPOKANE a/k/a THE CATHOLIC DIOCESE OF SPOKANE, a Washington corporation sole,	)	**JOINT OBJECTION OF CERTAIN INSURERS TO DEBTOR'S PROPOSED DISCLOSURE STATEMENT REGARDING PLAN OF REORGANIZATION DATED OCTOBER 10, 2005**
Debtor.	)	

General Insurance Company of America ("***General***") and ACE Property & Casualty Insurance Company, as successor in interest with regard to policies issued by Aetna Insurance Company ("***ACE***"), object to the Diocese's Proposed Disclosure Statement Regarding Plan of Reorganization Dated October 10,

2005 (the ***"Disclosure Statement"***) because it lacks adequate information as required by section 1125 of title 11 of the United States Code (the ***"Bankruptcy Code"***). (General and ACE are referred to collectively as "***Certain Insurers***").

INTRODUCTION

Certain Insurers are alleged to have issued insurance policies to the Diocese (the "***Policies***").[1] Certain Insurers have defended suits tendered by the Diocese alleging injury within their respective policy periods under a reservation of rights. Certain Insurers are each identified as "Insurers"[2] in the Disclosure Statement by reference to Article 2.65 of Debtor's Plan of Reorganization (the "***Plan***"). The Disclosure Statement states that "[e]ach Insurer will be given an opportunity to participate in the Plan and become a Settling Insurer."[3] (*Disc. St.* at 21). Settling Insurers, in exchange for their

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[1] ACE, through its predecessor, Aetna Insurance Company, is alleged to have issued a policy covering the period February 1, 1981 to February 1, 1982 (*Disc. St.*, Ex. 8). Neither ACE nor the Diocese has been able to locate a copy of any such insurance policy or any part thereof, however. The secondary evidence of such policy is incomplete. ACE reserves all rights to disclaim coverage, based on any coverage defense under applicable law, including but not limited to insufficiency of the evidence of material policy terms and provisions.

The Diocese alleges General issued policies from 1958 to 1972. Copies of policies for five of those years appear to have been located, and secondary documentation regarding the remaining nine years is incomplete. General has also reserved all its rights under any insurance contracts and applicable law.

[2] Unless otherwise noted, capitalized terms shall have the same meaning provided in Article 2 of the Plan.

[3] "Settling Insurers" is defined in the Plan as follows: "This term will refer to and mean those Insurance Companies that have reached settlements with the Diocese, and any Insurance Companies that may reach a settlement with the Diocese with respect to any Insurance Actions. Any Settling Insurer, in exchange for the Settling Insurer's contribution to the Fund as agreed upon between the Diocese and such Settling Insurer and approved by the Bankruptcy Court, will obtain the benefit of an injunction against prosecution of claims against the Insurance Company by any Creditor or other party in interest, including a Tort Claimant. The terms of any settlement with a Settling Insurer, if not previously approved by the Bankruptcy Court, pursuant to Bankruptcy Rule 9019, will be approved at the Confirmation Hearing and pursuant to the Confirmation Order. If an

contributions, will receive an injunction against "prosecution of claims . . . by any Creditor or other party in interest,[4] including a Tort Claimant." (*Plan* at Art. 2.107).

Certain Insurers' Basic Concerns

Certain Insurers are concerned the Plan may alter the rights and obligations of Insurers and improperly subject Insurers to decisions of the so-called "Special Arbitrator" sought to be appointed in connection with the Plan.[5] The extent to which the Plan would affect the rights of Insurers is unclear because the most critical Plan provisions are contained in documents – the Settlement Trust Agreement and the Litigation Trust Agreement (collectively, the "***Trust Agreements***") – that have not yet been provided. According to the Disclosure Statement, "[f]or a full description and understanding of the Settlement Trust, any reader of this Disclosure Statement should refer to the Settlement Trust Agreement." (*Disc. St.* at 36). Yet, the Diocese does not even

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agreement is reached with a Settling Insurer after the Effective Date, it will be approved by the Bankruptcy Court pursuant to its retained jurisdiction." (*Plan* at Art. 2.107)

[4] It should be noted that, although the definition of "Settling Insurer" provides for an "injunction against prosecution of claims against the Insurance Company by any Creditor or *other party in interest*," the actual injunction provision of the Plan (*Plan* at Art. 18.5) applies only to "all Persons who have held, hold, or may hold Channeled Claims or Claims against the Diocese, any Participating Third Party or Settling Insurer . . . and their respective agents, attorneys and all others acting for or on their behalf," and not to all other parties in interest. Accordingly, such injunction, if approved, should not, as the definition suggests, enjoin or otherwise bar all other parties in interest, like Certain Insurers, from pursuing claims against Settling Insurers (*e.g.*, claims for contribution).

[5] Certain Insurers' rights and duties under the Policies and applicable law are presently the subject of an action pending before Judge Quackenbush in the United States District Court for the Eastern District of Washington [Case No. 05-CV-00075 JLQ]. Certain Insurers are also concerned that the Plan will inappropriately affect the District Court proceeding.

intend to provide the Trust Agreements until after objections to the Disclosure Statement are due. (*See Disc. St.* at 8, n. 1) (Trust Agreements will be filed 20 days prior to the hearing on the Disclosure Statement). *See also* Notice of Filing of Written Disclosure Statement and Proposed Plan of Reorganization, dated October 20, 2005 (indicating hearing will be scheduled upon filing of written objections).

The failure to give parties in interest an opportunity to view the Trust Agreements should not be understated. The Settlement Trust is the centerpiece of the Plan. It is the vehicle to which all sexual abuse claims will be channeled unless the claimant specifically opts out of the Settlement Trust in favor of litigating his or her claim in state court (in which case the undisclosed Litigation Trust Agreement will govern). (*Disc. St.* at 36, 38). The failure to provide parties an opportunity to review the Trust Agreements (and the consequent absence of any meaningful disclosure as to their provisions) deprives parties of "adequate information" required by section 1125 of the Bankruptcy Code.

To better understand the Certain Insurers' concerns, and why disclosure is essential to their evaluation of the Plan, it is important that the Court understand that, to the extent the alleged Policies exist, they are contracts that do more than just obligate Certain Insurers to pay money on covered claims. Rather, they are a complex set of documents that set forth the contractual rights

and obligations of the insurer and the insured. Typical terms in the Policies, to the extent they exist, include the following:

- Terms providing insurers the right to participate and/or associate in the investigation, settlement or defense and control of any claim or suit;
- Specific notice requirements;
- Terms conditioning indemnity obligations on the entry of a final judgment against the insured after actual trial or by settlement approved in writing by the insurer;
- Anti-assignment provisions barring any assignment of interests under the policies without the written consent of the insurer;
- Requirement that the Diocese cooperate in all matters pertaining to the defense of claims;
- Limits on liability;
- Prohibitions against the insured voluntarily making a payment or incurring an obligation, except at the insured's own cost; and
- Clauses permitting insurers to seek subrogation, indemnity or contribution from third parties for losses paid under the policies.

The mechanism by which the Diocese proposes to determine and allow sexual abuse claims – *i.e.*, the channeling of claims to a trust – raises a host of potential issues regarding the rights of Certain Insurers under the Policies. Specifically, to the extent the Diocese seeks to have claims paid by proceeds of the Policies, Certain Insurers' rights regarding assignment of the Policies, the right to participate in and consent to any settlement of claims and other rights under the Policies may be violated. There is no basis in the Bankruptcy Code

for the Plan to impair, alter, diminish or affect the basic contractual and state law rights of Certain Insurers. In short, the Diocese cannot ask this Court to rewrite the Policies to fit within its proposed Plan.

Section 1125 of the Bankruptcy Code requires that the debtor provide adequate information to parties in interest to evaluate the Plan's intended impact on insurance policies, and Certain Insurers' rights thereunder. That information is necessary to make an informed judgment about the Plan's feasibility and whether the Diocese seeks to violate the Polices.

OBJECTIONS TO APPROVAL OF DISCLOSURE STATEMENT

I. The Disclosure Statement Should Not Be Approved Because It Does Not Provide Crucial Information Necessary to Evaluate the Plan's Impact on Certain Insurers' Rights

The Disclosure Statement is not adequate because it does not disclose information that is crucial to evaluating the Plan's impact on Certain Insurers' rights. In fact, the Disclosure Statement does not provide any information whatsoever about how the Plan will affect Insurers' rights and obligations under state law and/or their respective policies. In general, a plan of reorganization should not alter an insurer's rights under state law or its insurance policies. *See e.g.*, *Amatex Corp. v. Aetna Cas. Surety Co. (In re Amatex Corp.)*, 107 B.R. 856, 865-866 (E.D. Pa. 1989) ("The rights and obligations of the Debtor and [its insurer] under [the insurer's] policy are not altered because of the Debtor's

Chapter 11 filing."). *See also, Foothill Capital Corp. v. Clares Food Market, Inc. (In Re Coupon Clearing Service, Inc.)*, 113 F.3d 1091, 1099 (9th Cir. 1997) (the nature and extent of a debtor's interest in property is determined by state law, with the estate having no greater rights in property than those held by the debtor prior to bankruptcy); *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1213 (7th Cir. 1984) ("whatever rights a debtor has in property at the commencement of the case continue in bankruptcy – no more, no less"); *In Re Amatex Corp.*, 97 B.R. 220, 221 (E.D. Pa. 1989) ("we do not believe our equitable powers under sec. 105(a) or otherwise, can stretch so far as to alter contractual rights established under state law in a manner not expressly authorized by the Bankruptcy Code"), *aff'd*, *Amatex Corp. v. Stonewall Ins. Co.*, 102 B.R. 411 (E.D. Pa. 1989), *aff'd*, 908 F.2d 964 (3d Cir. 1990).

For this reason, many plans of reorganization contain "insurance neutral" language expressly stating that the plan will have no effect on the rights of insurers under state law or insurance policies.[6] *See In re Armstrong World*

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[6] Should the Court seek input regarding the proper neutral language, Certain Insurers would suggest consideration of (subject to review of further disclosures, including the Trust Agreements) the following language:

> None of the provisions, findings, or conclusion set forth in the Plan (however modified), including the Litigation Trust Agreement or the Settlement Trust Agreement, the final confirmation order, any other order ("Orders") entered in the bankruptcy case, and/or any order entered on appeal shall have any effect whatsoever on the legal, equitable or contractual rights or obligations of any Insurance Company. The Orders are not evidence relevant to or admissible in any dispute relating to insurance coverage between the Diocese (or, to the extent the Diocese's rights are assigned, the Trustees) and any Insurer. In addition, the Order shall not operate as any determination, judgment, adjudication, approval or settlement of, or be admissible as evidence of (i) any of the Diocese's or Trustees' obligation to any claimants, or (ii) any Insurer's liability to the Diocese or the Trustees. All of the rights and obligations of

Indus., Inc., Case No. 00-4471 (Bankr. D.Del.) Disclosure Statement Transcript at 138:-23 (April 4, 2003) [Dkt. No. 4465] (proposed insurance related findings should not be part of plan);[7] Stipulation and Order dated August 24, 2003 [Dkt. No. 5505] (regarding insurance neutrality); *In re Owens Corning*, Case No. 00-3837 (Bankr. D.Del.) [Dkt. No. 8811], June 4, 2003 Hearing Transcript at 46:17-47:4 (disclosure statement and plan of reorganization must be "insurance neutral"); *In re Combustion Engineering, Inc.*, Case No. 03-10495 (Bankr. D.Del.) Order Approving Disclosure Statement, etc. (June 23, 2003) [Dkt. No. 936] (findings impairing rights of insurers are impermissible and unnecessary). The Diocese's Plan, however, does not contain any such "insurance neutral" language; nor does the Disclosure Statement provide any insight into the Plan's effect on Insurers' rights. Accordingly, Certain Insurers are completely in the dark with respect to the Plan's preservation of their rights.

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each Insurer and the Diocese (including, without limitation, the existence of any party's liability, the right to trial by jury, and the reasonableness or fairness of any payment to a claimant) relating to any policy of insurance or contract relating to such policies, shall be adjudicated in any coverage action in accordance with the applicable non-bankruptcy law and those contracts. The Diocese's or Trustees' obligation to any claimants, if any exists, shall arise only at the time payment to an individual claimant is made when his/her individual claim is resolved.

None of the Diocese, the Tort Claimants' Committee, the Tort Litigants' Committee, the Future Claims Representative, the Special Arbitrator, or any other party may assert any position or offer any evidence, including, without limitation, the Orders, and are forever enjoined from making or consenting to any assertions or arguments that are contrary to or inconsistent with this order, in any forum. The Bankruptcy Court for the Eastern District of Washington shall retain and shall have jurisdiction to enforce this Order.

[7] This and the other citations, unless otherwise noted, are to unpublished orders, transcripts and stipulations in each of the respective cases. The documents cited herein were each retrieved from and are available on the electronic docket of the respective case. Upon request of the Court, Certain Insurers will provide copies of the documents.

Moreover, it appears that certain provisions of the Plan may impermissibly affect Certain Insurers' rights under Washington law and the Policies. For example,[8] the Plan provides for a Special Arbitrator to be appointed to hear and consider claims held by Settling Tort Claimants. (*Disc. St.* at 37). The Disclosure Statement further provides that "[t]he determination of the Special Arbitrator will be final and there will be no right of appeal from the determination of the Special Arbitrator." (*Id.*). Thus, it seems that the intent of the Plan is to elevate the settlements brokered by the Special Arbitrator, without any judicial review, to the status of allowed claims (and thus judgments) as opposed to contractual settlements. The Policies (to the extent they exist), on the other hand, give Certain Insurers the right and duty to defend lawsuits and to investigate, negotiate and settle claims or suits. They also require that Certain Insurers consent to any settlements entered into by the insured. Accordingly, it is unclear whether Certain Insurers' contractual right to challenge the reasonableness of the Special Arbitrator's settlements for purposes of coverage is preserved under the Plan. As a matter of Washington law, an insurer providing a defense under a reservation of rights, as is the case here, is entitled to a hearing to determine whether a settlement proposed by the insured is reasonable. *See Besel v. Viking Ins. Co.*, 146 Wash. 2d 730, 738-39

[8] Other examples of Plan provisions that may impermissibly alter Certain Insurers' contractual rights are discussed *infra*.

(2002). Therefore, the Plan may also impermissibly deprive Certain Insurers of their fundamental rights. To the extent the Plan seeks to alter contractual rights under the Policies or deprive Certain Insurers of their rights pursuant to state law, the Disclosure Statement should disclose the risk that the Plan cannot be confirmed in its present form.

In addition, the Disclosure Statement does not disclose how the Plan proposes to deal with the rights of parties other than the Special Arbitrator to object to claims under section 502 of the Bankruptcy Code. Parties in interest, including insurance companies, have rights to object to claims under section 502(a). *See In re Standard Insulation,* 138 B.R. 947 (Bankr.W.D.Mo.1992) (insurer has standing to object to claims under Section 502(a) of the Bankruptcy Code). The Disclosure Statement should disclose its impact upon the ability of parties in interest to object to claims.

Lastly, the Disclosure Statement does not disclose whether the Diocese believes that the Policies are executory contracts and, if so, whether the Diocese intends to assume such Policies. Certain Insurers do not believe that the Policies are executory contracts. To the extent that the Diocese believes otherwise, however, such belief should be disclosed.

II. The Disclosure Statement Should Not Be Approved Because It Does Not Contain Crucial Documents Necessary to Evaluate the Plan

According to the Disclosure Statement, the Trust Agreements will contain critical and fundamental Plan provisions, including the procedures for the treatment of Tort Claims. It is impossible for the Diocese to give adequate information about the Plan without disclosing such critical Plan provisions. To date, however, the Trust Agreements have not been disseminated. The Disclosure Statement provides that the Trust Agreements will be distributed 20 days prior to the Disclosure Statement Hearing. *(Disc. St.* at 8, n. 1). A hearing regarding the Disclosure Statement will only be scheduled if an objection to the Disclosure Statement is filed (*See* October 20, 2005 Notice). Accordingly, parties in interest will only have an opportunity to review the Trust Agreements if and when an objection to the Disclosure Statement is filed.

Before this Court rules on the adequacy of the Disclosure Statement, all parties in interest must be given adequate notice and an opportunity to review the Trust Agreements. Rule 2002(b) of the Federal Rules of Bankruptcy Procedure (the ***"Bankruptcy Rules"***) requires that parties be given 25 days' notice of the hearing on a disclosure statement. For that notice to be meaningful, the material portions of the Disclosure Statement and Plan must be provided at the outset of the notice period. Here, because the Trust Agreements have not been provided, parties in interest cannot evaluate the critical elements of the Plan, such as the criteria for evaluating and assigning claims to the various claim Tiers under the Settlement Trust and the range of values for those

Tiers. Without sufficient opportunity to review the Trust Agreements, the Disclosure Statement lacks adequate information on which parties in interest may make an informed judgment about the Plan.

III. The Disclosure Statement Contains Misleading Statements About the Role of Insurers in the Diocese's Bankruptcy

Reading the Disclosure Statement, one is left with the impression that, but for the actions of the Insurers, the bankruptcy of the Diocese would not have occurred. For example, in its section titled "The Reasons for Filing the Reorganization Case," the Diocese states, "Many dioceses around the country have, because of their own extensive, unrestricted, non-parish property holdings *and/or the attitude of their insurance carriers*, been able to avoid bankruptcy through multi-million dollar settlements." (*Disc. St.* at 28) (emphasis added). Later in that same paragraph, the Diocese asserts, "[T]he Diocese's insurance carriers were, by and large, not supportive of settlement prior to Chapter 11." These statements, and others, suggest that the Diocese could have avoided bankruptcy had the Insurers been even more cooperative in settlement and coverage matters. Such suggestion is completely false, and is directly at odds with statements made by the Diocese elsewhere in the Disclosure Statement and at other times during the course of this bankruptcy case.

The truth is that Certain Insurers have defended, under a reservation of rights, all suits tendered to them in which injury during their respective policy

periods is alleged. They have also agreed to participate where appropriate in attempted mediation, under reservation of rights, of certain prelitigation claims. In fact, the Disclosure Statement states that of 19 sexual abuse lawsuits filed, the defense of 15 of those lawsuits was accepted by various Insurers. (*Id.* at 27).

At the time the Diocese filed the bankruptcy petition, it was facing trial on the first of several claims alleging abuse by former priest Patrick O'Donnell. (*Id.*). The Disclosure Statement describes the O'Donnell claims and the failed mediation prior to trial. (*Id.*). However, the Disclosure Statement's description of the O'Donnell claims omits certain key facts that were included in prior pleadings before this court, including in the "Background" section of each of the Diocese's "first day" pleadings. (*See, e.g., Motion for Order Authorizing and Approving Payment of Prepetition Wages*, filed Dec. 6, 2004 (the "***Wages Motion***")). Significantly, each of the first day pleadings states, "the settlement demands for the O'Donnell Claimants alone totaled $55 million, *an amount which far exceeds the total of available insurance for those claims and the net worth of the Debtors*." (*Wages Motion* at 6) (emphasis added). The first day pleadings then state that the Diocese filed its chapter 11 petition one week after the failed mediation, apparently as a direct result of the failed mediation and impending trial. (*Id.* at 6-7). The Disclosure Statement contains an identical

description of the O'Donnell claims and the failed mediation, except that it omits these two key sentences.[9]

The fact is, by its own admission, the Diocese was facing an imminent trial and potential liability far in excess of any insurance coverage (even if coverage for those claims existed). The Diocese has indicated previously that it estimates that total insurance coverage, "assuming the Debtor prevails on the issues in dispute, is in the range of $15 million . . . ." (*Debtor's Proposed Case Management Order In Response to Court's Scheduling Order* (the "***Proposed CMO***") at 10). According to the Disclosure Statement, "[t]he Tort Litigants' claims alone, as of the Date of Filing, totaled approximately $75 million." (*Disc. St.* at 24, n. 13). Furthermore, the Diocese has acknowledged that "Committee Counsel has informed the [Diocese] that they do not believe that even the most favorable resolution of insurance coverage issues is likely to be sufficient to resolve the claims of the tort claimants." (*Proposed CMO* at 11).

It is disingenuous for the Diocese to suggest now, through the Disclosure Statement, that lack of cooperation from Insurers is a primary factor in the cause of its bankruptcy. The course of events leading up to its bankruptcy and the Diocese's own admissions and statements in pleadings before this Court make clear that, whatever liability the Diocese believes might be covered by

[9] *Compare Wages Motion* at p. 6-7 and *Disclosure Statement* at p. 27-28.

insurance, such amount is far less than even its own view of its total exposure. The Disclosure Statement should make clear the real factors leading to the Diocese's bankruptcy.

IV. The Disclosure Statement Fails to Disclose that Insurer Consent May Be Required for Assignment of the Insurance Actions and that Certain Insurers Have Not So Consented

The Disclosure Statement states that, to the extent the Insurance Actions are not resolved prior to confirmation, the Diocese "may assign all rights and interests in the Insurance Actions to the Trustees as determined by the Bankruptcy Court as part of the confirmation process." (*Disc. St.* at 40). Insurance Actions are defined as follows:

> [A]ll claims, causes of action and enforceable rights of the Debtor against any Insurer, including, but not limited to, those arising from or related to: (a) any such Insurer's failure to provide Insurance Coverage under any Insurance Policy; (b) the refusal of any Insurer to compromise and settle any claim pursuant to any such Insurance Policy; (c) the interpretation or enforcement of the terms of any such Insurance Policy and Insurance Coverage; or (d) any claim, cause of action or rights asserted by the Diocese against any Insurer in the Declaratory Relief Action.

(*Plan* at Art. 2.61).

It is unclear from the Disclosure Statement whether the Diocese contemplates assigning only certain causes of action that it may hold or whether it contemplates assigning all rights under the Insurance Policies. To the extent

that the Plan proposes to assign the Diocese's rights under the Insurance Policies, the Policies (to the extent they exist) would require the consent of Certain Insurers. The Disclosure Statement does not disclose that Certain Insurers have not provided such consent to the Diocese. In fact, the Disclosure Statement does not even disclose that the Policies would require Certain Insurers' consent to assignment.

Moreover, the Insurance Policies cannot be assigned in situations where the insurer's contractual risk is to be modified. *See Henkel Corp. v. Hartford Accident and Indemn. Co.*, 62 P.3d 69, 75 (Cal. 2003) (it is reasonable to uphold an insurer's contractual right to accept or reject an assignment, in view of the potential for increased burdens). A purported assignment by a debtor is ineffective to transfer rights where the transfer increases the insurer's risk and is inconsistent with the insured's duty to cooperate in its own defense. *See Caldwell Trucking PRP Group v. Spalding Composites Co., Inc.*, 890 F. Supp. 1247, 1260-61 (D.N.J. 1995).

In this case, the Insurance Policies would be modified if, upon assignment of the policies, an Insurer's obligation to pay damages, to participate in the defense of claims, and to receive the cooperation of the insured will be modified. Assignment may also increase an Insurer's risk by replacing the current insured Diocese – which shares an interest in limiting claims and which is contractually obligated to cooperate with the Insurer – with

two unidentified Trustees, each with conflicting duties. That is not the same risk that an Insurer undertook when it chose to enter into an insurance contract with the Diocese.

Of course, at this juncture, it is impossible to fully ascertain how an Insurer's rights would be altered by an assignment because the Trust Agreements have not been provided. Indeed, it is impossible to determine how insurance proceeds will be channeled into the Trusts. It is also impossible to understand how, and under what authority, the Diocese intends to assign Insurance Actions to both the Settlement Trust and Litigation Trust, particularly when the two Trusts may have potentially conflicting interests. Therefore, at a minimum, the Disclosure Statement should disclose that there is a material risk that any proposed policy assignment will not be effective and that any insurance coverage purported to be assigned by the Plan may not be available.

V. The Disclosure Statement Fails to Disclose Provisions That Are At the Heart of the Plan of Reorganization

The treatment of tort claims is at the heart of any plan of reorganization in a mass tort driven bankruptcy case. Surprisingly, however, neither the Plan nor the Disclosure Statement provides the most vital information regarding the treatment of Tort Claims – an estimated range of recovery for Tort Claimants or the parameters by which such claims will be judged. Instead, both pieces of important information – information necessary to determine whether to vote to

accept or reject the Plan and/or whether to object to confirmation of the Plan – will be determined either at the Confirmation Hearing or at some time subsequent thereto.

With respect to Settling Tort Claimants, the Plan provides for each of their claims to be placed into one of three Tiers based on certain "parameters." (*Plan* at Art. 2.114 - 2.116). Neither the Plan nor the Disclosure Statement, however, provides any insight into what such "parameters" might be. The Plan provides for the "parameters" for Tier One to be determined prior to the Confirmation Hearing and for the "parameters" for Tiers Two and Three to be determined prior to the Disclosure Statement Hearing. (*Id.*). The Disclosure Statement provides that the "criteria" for all three Tiers will be determined as a part of the confirmation process. (*Disc. St.* at 37). The Insurers submit that, while it is appropriate for the parameters for settling claims to be *approved* in connection with confirmation, section 1125 of the Bankruptcy Code requires that the proposed parameters be *disclosed* in the Disclosure Statement.

Moreover, the Disclosure Statement states that each Tier will be assigned a range of monetary recovery at the Confirmation Hearing. (*Disc. St.* at 37). The Plan also provides that the "presumptive amount" to be paid to a Settling Tort Claimant will be proposed by the Diocese within thirty days of the Date of Finality. (*Plan* at Art. 2.114 - 2.116). Thus, the range of recovery for Settling Tort Claimants will not be determined until after the Plan objection deadline,

and the individual recovery amounts will not be disclosed until thirty days after the date that an order deciding the property of the estate issue becomes final, which date most likely will occur well after the Effective Date of the Plan. Clearly, this type of delayed disclosure is inadequate.

As proposed, the Disclosure Statement does not provide even an estimate of what Tort Claimants will receive or a proposal for how their claims will be valued. Without information as to the claims resolution criteria and recovery levels within the proposed Tiers in connection with the Settlement Trust, it is impossible for the Insurers to know whether the Plan would impermissibly permit payment of claims that are invalid or otherwise unallowable under bankruptcy and/or nonbankruptcy law. To the extent that the Plan contemplates recovery by the insured to pay claims that are unsupported, unmeritorious or improperly valued, Certain Insurers' rights under their Policies will be violated. Accordingly, it is essential that the Diocese disclose information regarding the proposed settlement parameters and the proposed amount of recovery in the Disclosure Statement in order to allow parties in interest to make an informed decision with respect to the Plan.

VI. The Disclosure Statement's Description of the Appointment and Duties of the Special Arbitrator Is Insufficient

The Disclosure Statement provides as follows:

> There will be a Special Arbitrator suggested by the Tort Litigants' Committee, the Tort Claimants' Committee and the Future Claims Representative in consultation with the Diocese and approved by the Bankruptcy Court. The Special Arbitrator will hear and consider each Claim of a Settling Tort Claimant in accordance with the provisions of the Settlement Trust Agreement.

(*Disc. St.* at 37).

Thus, the Special Arbitrator will have extraordinary power to determine the validity and value of claims, by placing each claim in one of three Tiers "in accordance with criteria suggested by the Committees and FCR, with input from the Diocese." (*Id.*). Moreover, the decision of the Special Arbitrator will be final and non-appealable. (*Id.*). Yet, despite the important role that the Special Arbitrator will play, the Disclosure Statement provides no further information about the selection of the Special Arbitrator, the standards by which potential special arbitrators will be judged or the extent of the Special Arbitrator's duties and obligations. In light of the crucial role that the Special Arbitrator will have in determining the recovery to Settling Tort Claimants, the Disclosure Statement should provide parties in interest with more complete information.

VII. The Disclosure Statement Should Disclose Information Regarding the Aggregate Value of Claims and Its Impact on Confirmation of the Plan

The Diocese states that it "cannot, at this time, estimate the magnitude or amount of the Tort Claims." (*Disc. St.* at 24). However, the Disclosure Statement does reveal that "[t]he Tort Litigants' claims alone, as of the Date of Filing, totaled $75 million." (*Id.* at n. 13). The Disclosure Statement further states that, in addition to the existing Tort Claims, "there likely are Tort Claimants who, for one reason or another, have not yet come forward and therefore, are not known to the Diocese" and that there "may be other potential Tort Claimants whose memories are repressed or have not connected an abusive event(s) with damages relating thereto . . . ." (*Id.* at 24).

The Diocese provides no further information regarding (i) whether the Diocese will seek to estimate claims for purposes of confirmation or for voting on the Plan, (ii) the likely range of aggregate claim value and the basis therefor, and (iii) what effect, if any, the value of the Tort Claims will have on feasibility of the Plan. The lack of disclosure on this point is surprising given that the Diocese stated in its Proposed CMO that "[t]he [Diocese] believes . . . that a claims estimation process should be established prior to confirmation and that the Court should be actively involved in establishing a process that will result in the estimation of unliquidated, disputed sexual abuse claims . . . ." (*Proposed CMO* at 15). If the Diocese has changed its view as to the necessity of claims estimation, it should disclose that fact.

Whether or not the Diocese will seek to estimate claims may be particularly important in light of the property of the estate litigation. Article 11.2 of the Plan suggests that, if the Court's property of the estate ruling is upheld, the Diocese may still seek a settlement that would provide less than 100% payment of claims. Estimation of claims may be particularly important in this regard. On the other hand, many mass tort bankruptcy cases have been confirmed without estimation of claims, leaving that issue to the trustees of the plan trust to determine post-confirmation when fixing initial distributions from the trust.[10] Alternatively, the creditors' committee and unknown claims representative can simply reach an agreement regarding the initial distribution amounts and the reserve. Whatever the Diocese's intentions are with respect to these matters, they should be disclosed.

VIII. The Disclosure Statement's Description of the Best Interest of Creditors Test and Its Liquidation Analysis Are Incomplete

The Disclosure Statement's description of the best interest of creditors' test under section 1129(a)(7) of the Bankruptcy Code is incomplete. The Diocese asserts that, because it is a non-profit entity that cannot be converted to chapter 7 involuntarily under section 1112(c) of the Bankruptcy Code, it should not be forced to satisfy the section 1129(a)(7) requirements. (*Disc. St.* at 58-

[10] For example, there was no claim estimation hearing in the Tucson Diocese bankruptcy case.

59). Rather, the Diocese suggests "that the best interest of creditors standard be applied to compare this Plan to the true alternative of dismissal and a race to the courthouse which greatly benefits the first to sue over the claims of others." (*Id.*).

This is simply inappropriate. Every debtor seeking to confirm a plan of reorganization under chapter 11 of the Bankruptcy Code must satisfy each element of section 1129 of the Bankruptcy Code. *See* 11 U.S.C. § 1129(a) ("The court shall confirm a plan only if all of the following requirements are met"). Section 1129(a)(7)(A)(ii) requires, with respect to each class of impaired claims, each creditor:

> will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date.

This provision "ensures that the dissenting claimants receive in payment of their claims no less than they would receive if the debtor were liquidated under Chapter 7." *In re Dow Corning Corp.*, 255 B.R. 445, 499 (E.D. Mich. 2000). Section 1129(a)(7) does not ask what would actually occur in the absence of confirmation, as the Diocese suggests. Rather, "[t]he application of the best interests test *involves a hypothetical application of chapter 7* to a chapter 11 plan." *In re Lisanti Foods, Inc.*, 329 B.R. 491, 500 (Bankr. N.J. 2005) (emphasis added). It makes no difference for purposes of the mandatory

application of section 1129(a)(7) whether the Diocese's chapter 11 case could in fact be converted to a chapter 7 case. The liquidation analysis required to satisfy section 1129(a)(7) is purely hypothetical.

The Disclosure Statement does not include a liquidation analysis, which is required in order to provide adequate information in satisfaction of section 1125 of the Bankruptcy Code. *See In re EPB, Inc.*, 172 B.R. 241, 246 (Bankr. N.D. Ohio 1994) ("[A]dequate information requires that a liquidation analysis be provided" in disclosure statement). Instead, the Disclosure Statement provides that a liquidation analysis will be provided (i) as part of the confirmation process and (ii) within 20 days of the Date of Finality (which will, in all likelihood, take place well after the Court has entered a Confirmation Order and the Plan has become effective).[11] (*Disc. St.* at 59). Regardless of the inconsistency, it appears that a liquidation analysis will only be provided to parties in interest after the objections to the Disclosure Statement are due. As with other critical plan documents, such as the Trust Agreements, parties in interest must be given an opportunity to view the liquidation analysis in order to make an informed judgment. Given this Court's ruling that property of the estate includes parish property (and the uncertainty as to whether that issue will be resolved by the effective date of the Plan), a detailed liquidation analysis that

[11] The occurrence of the Date of Finality is not a condition to confirmation or effectiveness of the Plan.

discusses all of the potential outcomes regarding property of the estate is essential to provide adequate information about the Plan as required by section 1125.

IX. The Disclosure Statement Does Not Satisfy the Requirement of Bankruptcy Rule 3016(c)

Bankruptcy Rule 3016(c) provides that, where a plan of reorganization contains "an injunction against conduct not otherwise enjoined under the Code, the plan and disclosure statement shall describe in specific and conspicuous language (bold, italic, or underlined text) all acts to be enjoined and identify the entities that would be subject to the injunction." F.R.B.P. 3016(c). Both the Diocese's Plan and the Disclosure Statement lack specific and conspicuous language explaining that the Plan enjoins claimants from pursuing claims against Participating Third Parties and Settling Insurers. (*Plan* at Arts. 18.3 and 18.5). Thus, in order to comply with Bankruptcy Rule 3016, which is not discretionary, the Diocese must amend the Disclosure Statement to, *inter alia*, boldly and conspicuously notify claimants that the Plan enjoins them from pursuing claims against certain third parties.

X. The Disclosure Statement Does Not Provide Adequate Disclosure Regarding the Treatment of Certain Classes of Claims

A. Class 1 – Priority Employee Unsecured Claims. The Plan provides that Priority Employee Unsecured Claims are impaired, will not be paid in cash and will be honored in the ordinary course. (*Plan* at Art. 5). The Disclosure Statement, however, does not explain why, if these claims are to be honored in the ordinary course, these claims are impaired.

B. Class 4 - Parish and Catholic Entity Unsecured Claims. Both the Plan and Disclosure Statement provide that

> [e]ach Allowed Parish and Catholic Entity Unsecured Claim that is not otherwise contributed or becomes part of the consideration for a Parish or Catholic Entity to participate as a Participating Third Party will be treated as follows: subsequent to the time all payments to members of Class 4 have been paid in full in accordance with the terms of the Plan, the remaining Allowed Parish and Catholic Entity Unsecured Claims shall be repaid without interest in sixty (60) equal monthly installments.

Presumably, the reference to payment in full of Class 4 (*Plan* at Art. 8); *Disc. St.* at 34) is a typo, and the Diocese meant to say Class 7 (the class of Tort Claimants). (*See Disc. St.* at 9). Regardless, the description of this provision in the Disclosure Statement is ambiguous. First, it is unclear whether payment of claims in Class 4 will be made subsequent to the time that the Diocese has met all its obligations to fund the Settlement Trust and the Litigation Trust, or subsequent to the time when all holders of Tort Claims are paid 100% of their allowed claims by the Settlement Trust or the Litigation Trust, as applicable. Second, the Plan contemplates that the assets of the Settlement Trust and the

Litigation Trust may be insufficient to pay Tort Claims in full. It is unclear whether Class 4 will receive any recovery if Class 7 is not paid in full, and the Plan makes no provision for this possibility.

C. Class 7 – Tort Claims. The Plan provides for the formation of two trusts, the Settlement Trust and the Litigation Trust, which, together, will provide for the liquidation and payment of all Class 7 claims when they become Allowed Claims. The Disclosure Statement, however, does not explain why even one trust is necessary to address these claims. Trusts are typically used as a vehicle for addressing claims in bankruptcy cases where there are thousands of claims to process. In this case, it is likely that only, at most, a few hundred claims will be filed. The Disclosure Statement does not discuss the benefit of a trust, as opposed to simply having the Reorganized Debtor liquidate and pay claims based upon the approved parameters and then be responsible for pursuing insurance coverage. In addition to saving administrative costs, this would potentially solve problems attendant to the assignment of the Insurance Policies to the Trusts.

Moreover, the Disclosure Statement does not contain information regarding who the Trustees of the Settlement Trust or the Litigation Trust will be or how they will be selected.

In addition, the Disclosure Statement does not adequately explain the Plan's treatment of Future Tort Claimants. For example, it is not clear whether

Future Tort Claimants will automatically be characterized as Settling Tort Claimants or whether they will be given an opportunity to elect to be treated as Non-Settling Tort Claimants (preserving their rights to a jury trial). Further, although the Disclosure Statement discusses the establishment of a reserve for Future Tort Claims (*Disc. St.* at 7), it does not discuss whether the FCR will have any continuing involvement with the Trusts.

Lastly, the Plan contemplates that the Diocese will have six months from the Date of Finality (which will most likely be well after the Effective Date of the Plan) to secure sufficient supplemental funding for the Fund through, among other things, obtaining financing. The Disclosure Statement does not disclose any information regarding how much such Additional Funding would be if the Diocese does not prevail in the property of the estate litigation, whether the Diocese would have the ability to obtain such level of financing, or what would be the consequences if the Diocese is unable, or simply fails, to obtain the Additional Funding.

XI. Miscellaneous Objections to Disclosure Statement

A. Page Six of the Disclosure Statement. The phrase "at least one Class of Impaired Claims has voted to accept the Plan" should be amended to read "at least one Class of Impaired Claims (excluding the votes of insiders) has voted to accept the Plan."

B. Disclosure of Value of Parish Real Property/Interest in Other Non-Profit Corporations. The Disclosure Statement does not indicate the estimated amount of the Parish Real Property and likewise fails to state the estimated value of the Bishop's interest in Other Entities. The Disclosure Statement does note that the nature and extent of the Diocese's interest in the Parish Real Property and the Other Entities is the subject of unresolved litigation. (*Disc. St.* at 22). While it is true that the Diocese's interest in the Parish Real Property and the Other Entities is the subject of unresolved disputes, such disputes do not preclude the Diocese from disclosing the estimated value of such property, which is pertinent information regarding the value of the Diocese's assets (or potential assets) that should be disclosed.

CONCLUSION

For the reasons stated herein, the Disclosure Statement fails to provide adequate information regarding material aspects of the Plan and fails to disclose material risks associated with the Plan. Without such information, the Disclosure Statement does not satisfy the requirements of section 1125 of the Bankruptcy Code, and it should not be approved.[12]

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[12] Certain Insurers expressly reserve, and do not waive, all of their respective rights, defenses, limitations and/or exclusions in connection with the Policies, applicable law or otherwise. Certain Insurers further reserve all of their respective rights to assert and all such respective rights, defenses, limitations and/or exclusions in any action to determine Certain Insurers' respective liability for coverage under the Policies. Nothing contained in this objection shall be deemed to expand any coverage that may otherwise be available under any insurance policies or otherwise. Nothing in this objection shall be construed as an acknowledgement that any policies or prepetition settlement agreements cover or otherwise apply to any claims, losses or damages on account of any claims or otherwise, or that any such claims or causes of action are eligible for payment. Certain Insurers

Moreover, from a review of the very short objections filed by the Tort Claimants' Committee and the Future Claims Representative, it appears that the Diocese has indicated to certain parties (but not Certain Insurers) that it does not intend to proceed with the current form of Disclosure Statement. Accordingly, to the extent that the Diocese amends its Disclosure Statement, Certain Insurers reserve their rights to file subsequent objections thereto.

RESPECTFULLY SUBMITTED, this 15th day of November, 2005.

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reserve their respective rights to amend, modify or supplement this objection in response to, or as a result of, the filing of any Plan supplement by the Diocese, any discovery being conducted in connection with confirmation of the Plan, and/or any submission in connection with the Plan or this bankruptcy case filed by any party in interest. Certain Insurers also reserve their respective rights to adopt any other objections to approval of the Disclosure Statement filed by a third party.

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