PLAINTIFF'S EXHIBIT

NAR-245

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

In re:	§	
	§	In Proceedings for a Reorganization under Chapter 11
NORTH AMERICAN REFRACTORIES COMPANY	§	
	§	
Debtor.	§	Case No. 02-20198
	§	
NORTH AMERICAN REFRACTORIES COMPANY,	§	
	§	
Plaintiff,	§	
	§	Adversary Proceeding No. 02-2004
vs.	§	
	§	
PARTIES LISTED ON EXHIBIT A	§	
	§	
Defendants.	§	

RESPONSE AND MEMORANDUM OF LAW IN OPPOSITION TO DEBTOR'S MOTION FOR TEMPORARY RESTRAINING ORDER AND FOR PRELIMINARY INJUNCTION AND IN SUPPORT OF MOTION TO DISMISS COMPLAINT FOR DECLARATORY RELIEF

TO THE HONORABLE JUDITH K. FITZGERALD,
UNITED STATES BANKRUPTCY JUDGE:

Reaud, Morgan & Quinn, Inc. ("Reaud, Morgan") attorneys of record for numerous personal injury plaintiffs (the "Tort Victims") in pending cases against Honeywell International, Inc., including plaintiffs referenced on the Supplement to Exhibit A filed in connection with the Complaint for Declaratory and Injunctive Relief (the "Complaint") filed herein by North American Refractories Company ("Debtor") respectfully files this memorandum in opposition to

Debtor's motion for injunctive relief and in support of its Motion to Dismiss (the "Motion") the Complaint.

I. THE PARTIES TO THIS ADVERSARY PROCEEDING

A. The Real Plaintiff is Honeywell which Paid $100 million to be here today.

One day prior to the Petition Date, Honeywell International Inc. ("Honeywell"), one of the largest industrial firms in the United States, entered into a scheme, with the active collaboration of Austrian giant RHI AG (Debtor's ultimate owner) and RHI Refractories Holding Company ("RHI"), to use the Debtor to manipulate the federal bankruptcy process. Lest this be viewed as hyperbole or the argument of zealous counsel, here is the exact language of the January 3 agreement between Honeywell and RHI (the "Honeywell Agreement"):

> 2.A. **If, on or about January 4, 2002, NARCO files a petition of relief (the "Petition") under Chapter 11** of the Bankruptcy Code (the "Chapter 11 Case") in the United States District Court for the Western District of Pennsylvania (the "Bankruptcy Court"), **Honeywell shall upon filing of the Petition pay to RHI by wire transfer of immediately available funds the sum of $40,000,000.**
>
> 2.B. **If NARCO complies with its obligations** under the NARCO Agreement after the filing of the Petition **to seek, by means of an adversary proceeding in form and substance satisfactory to Honeywell, an injunction under Sections 362 and 105 of the Bankruptcy Code to stay any litigation against Honeywell arising out of the NARCO business** (the "Honeywell Actions"); and if Honeywell decides to remove any or all present or future Honeywell Actions to federal courts, NARCO cooperates with Honeywell in seeking such removal, and in such event, NARCO seeks to consolidate all such actions in the United States District Court in which the Chapter 11 Case is pending, **then upon (1) NARCO's filing of a plan of reorganization (the "Plan") that is acceptable to Honeywell in its sole discretion, pay to RHI $20 million by wire transfer of immediately available funds, and (2) confirmation and consummation of a Plan that is acceptable to**

> Honeywell in its sole discretion, pay to RHI the additional sum of $40 million by wire transfer of immediately available funds.
>
> 2.C **Upon the commencement of the NARCO Chapter 11 Case, Honeywell shall provide RHI with a clean irrevocable standby letter of credit (1) in the amount of $20 million** that may be drawn by RHI in the event that Honeywell fails to make payment in accordance with paragraph 2(B)(1) above, **and (2) in the amount of $40 million** that may be drawn by RHI in the event that Honeywell fails to make payment in accordance with paragraph 2(B)(2) above.

Thus, it is clear that the real party in interest in this Adversary Proceeding is the non-debtor megafirm Honeywell. A complete copy of the Honeywell Agreement is attached hereto as Exhibit A. Honeywell seeks to buy the Bankruptcy Code's (the "Code") protections without submitting to the bankruptcy court's jurisdiction and without undertaking the many obligations of a debtor under Chapter 11[1].

B. Debtor Tries to Sell the Court's Injunctive Powers to Honeywell for Cash.

Thus, in a clear dereliction of the fiduciary duties of a debtor-in-possession, Debtor allowed itself to be used by Honeywell to urge a course of conduct that is wholly controlled by Honeywell, which was entitled to approve the Complaint in this proceeding and ultimately the plan which the Debtor refers to in the same Complaint. Debtor has "sold" this bankruptcy to Honeywell for at least $100,000,000, which has already been paid, in cash or in "clean irrevocable" letters of credit. A first installment of $40,000,000 was paid for the Complaint, and the "clean irrevocable" letters of credit in the amount of $60,000,000 have been prepaid for the Plan.

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[1] It does not stretch the imagination to wonder if the payment of such enormous sums in order to influence the position of a party in a bankruptcy proceeding might implicate 18 U S.C. §152(6).

C. The Defendants are Tort Victims of Honeywell's Own Product Lines.

Seeking redress for their injuries, the Tort Victims instituted suit (the "Tort Litigation") in the district courts for Jefferson and Orange Counties, Texas. In the Tort Litigation, they have asserted personal injury claims, wrongful death claims, and other causes of action against both Debtor and Honeywell (or one of its subsidiaries or predecessors in interest). The Tort Victims understand that they are stayed by 11 U.S.C. §362(a) from continuing their Tort Litigation against the Debtor. They do not understand why their claims against Honeywell for Honeywell product lines should be stayed merely because the Debtor has been paid $100,000,000 (plus a "loan" of $20,000,000) to aid Honeywell. The Debtor cleverly insinuates that Honeywell is being mired in litigation over "NARCO product lines." A simple reading of the Debtor's own Exhibit A to its Memorandum shows that the NARCO product line was Honeywell's own product line, which it has attempted to shuffle off onto a newly formed company which is now the Debtor. The "NARCO" which is the debtor here, is a creation of Honeywell's management in 1985. It was not even in existence when Honeywell was actively in the asbestos business. As will be explored more fully below, the Debtor's case vanishes once one knows that Honeywell is liable independently for asbestos claims.

II. PROCEDURAL BACKGROUND

Debtor filed this Adversary Complaint on the Petition Date, January 4, 2002, after binding itself to do so by receiving the massive payments from Honeywell. By its Complaint, Debtor enlists this Court's assistance in slamming the courthouse door in the Tort Victims' faces as to the prosecution of their claims against Honeywell for asbestos-related injuries arising out of Honeywell's own product lines. Debtor on behalf of Honeywell asks the bankruptcy court to stay asbestos litigation properly brought against Honeywell, and, audaciously, asks the Court to confirm a plan that would enjoin Tort Victims injured by Honeywell's products from suing Honeywell!

In the *Complaint*, Debtor asks this Court either to declare that the Tort Victims are *stayed from pursuing* Honeywell by section 362(a) of the Code or, alternatively, to stay the Tort Victims from pursuing Honeywell pursuant to section 105(a) of the Code. In response to the Complaint, the Tort Victims have filed the Motion seeking dismissal pursuant to FED. R. BANKR. P. 7012(b)(6), contending that Debtor has failed to state a claim upon which relief may be granted.

II. LEGAL ISSUES

As set forth below, the answers to the following two questions control disposition of the Motion:

(1) Are the Tort Victims barred by 11 U.S.C. § 362 from pursuing Honeywell in the Tort Litigation?

(2) May this Court, pursuant to 11 U.S.C. § 105(a), enjoin the Tort Victims from pursuing Honeywell in the Tort Litigation?

Inasmuch as the answer to both questions is resoundingly "no," this adversary proceeding should be dismissed.

III. ARGUMENT

A. THE BANKRUPTCY DOES NOT PROTECT NON-DEBTORS FROM LITIGATION, ESPECIALLY WHERE IT ARISES OUT OF THEIR OWN CONDUCT

1. Honeywell International Inc. was a Major Asbestos Producer in its own Right.

Honeywell is a colossal multinational corporation which *is one of only thirty companies to be listed in the Dow Jones Industrial Averages and which has a market capitalization of $26 billion dollars.* Honeywell was a major asbestos producer, owning subsidiaries that produced asbestos at least since 1961 (Complaint ¶13), and thus was knowingly manufacturing and distributing a product that has caused injury to untold numbers. As Debtor's Complaint itself makes clear, it attempted to divest itself of its asbestos liabilities by selling its NARCO product line to a new company led by a management group, and through a series of mergers and name changes, to shed its origins. But the Complaint states it best: Honeywell is a name change from Allied Signal, the owner of the NARCO business through a variety of mergers (NARCO merged with Eltra which merged with Allied, the wholly owned subsidiary of Honeywell). Therefore, Honeywell has been dealing with asbestos issues since at least 1961. Complaint ¶¶9-12.

2. **The NARCO Indemnities do not create Honeywell's Asbestos Liabilities.**

It is important to note that Honeywell is independently liable for asbestos-related injury. Honeywell was an asbestos-producer and the Tort Victims seek recovery based on Honeywell's own production or distribution of asbestos or asbestos-containing products. It could not avoid these by selling them to the newly-created NARCO in 1986. Honeywell is properly liable to Tort Victims for injuries, whenever occurring, for the products it manufactured or distributed. That it foisted its asbestos-producing business on the management-led group that bought those assets does not affect the rights of the Tort Victims: they may pursue Honeywell just as they could have before the sale of the asbestos-producing business to the NARCO investors. Most if not all of the claims which Honeywell, through the Debtor, seeks to enjoin are the result of products manufactured by Honeywell *prior to the corporate existence of the Debtor*. This alone shows the illogic of this Debtor's attempt to enjoin litigation arising before it was born.

3. <u>Two Solvent Non-Debtor Corporate Giants Should Not Be Allowed to Distort the Bankruptcy Process.</u>

Honeywell entered into the remarkable Honeywell Agreement with RHI whereby in exchange for huge monetary contributions, RHI agrees to act in concert (the "Honeywell Agreement") to obtain for a solvent Honeywell the benefits of injunctions under the Bankruptcy Code §§362(a) and 524(g) without Honeywell's having to file for bankruptcy. Honeywell has apparently advanced some $100,000,000.00 to the Debtor's parent RHI to induce Debtor to use the bankruptcy process for Honeywell's benefit. As one Court of Appeals has noted, this completely distorts Congress' intent written into the Bankruptcy Code:

> It is universally acknowledged that an automatic stay of proceeding accorded by § 362[(a)(1)] may not be invoked by entities such as sureties, guarantors, co-obligors, or others with a similar legal or factual nexus to the...debtor. ... Nothing in the legislative history counsels that the automatic stay should be invoked in a manner which would advance the interests of some third party, such as the debtor's co-defendants, rather than the debtor or its creditors. **This Court concurs with the district court's conclusion that "it would distort congressional purpose to hold that a third party solvent co-defendant should be shielded against his creditors by a device intended for the protection of the insolvent debtor and creditors thereof.**

Lynch v. Johns-Manville Sales Corp, 710 F.2d 1194, 1196-97 (citations omitted) (emphasis supplied).

B. BANKRUPTCY INJUNCTIVE RELIEF IS NOT AVAILABLE TO NON-DEBTOR CODEFENDANTS.

1. <u>362(a) is Limited By Its Terms to the Debtor Itself.</u>

Only two provisions of § 362 of the Code may affect the Tort Victims' pursuit of Honeywell. First, § 362(a)(1) provides that commencement of a bankruptcy case stays "the... continuation... of a judicial .. proceeding against the debtor that was... commenced before the commencement of the case ...' Second, § 362(a)(3) operates as a stay of "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate...." 11 U.S.C. § 362(a). For the reasons set out below, no 'unusual circumstances" exist that would warrant extending the reach of those sections.

2. **<u>11 U.S.C. § 362(2)(a)(1) should not be stretched to encompass a Non-Debtor where, as here, there are no unusual circumstances.</u>**

a. ***There is no identity of interests between Honeywell and the Debtor.***

It is clear that § 362(a)(1) has no application to the instant case. The plain language of § 362(a)(1) limits its effect to the "continuation ... of a ... proceeding *against the debtor....*" (emphasis supplied). Section 362(a)(1) does not provide any protection to a non-debtor. *Wedgeworth v Fibreboard Corp.*, 706 F.2d 541, 544 (5th Cir. 1983) (holding that § 362 does not operate as an automatic stay of claims against the debtor's non-bankrupt co-defendants); *Maritime Electric Co v. United Jersey Bank*, 959 F.2d 1194, 1205 (3rd Cir. 1991) ("[T]he automatic stay is not available to non-bankrupt co-defendants of a debtor even if they are in a similar legal or factual nexus with the debtor"); *Fortier v. Dona Anna Plaza Partners*, 747 F.2d 1324, 1330 (10th Cir. 1984); *In re First Central Financial Corp.*, 238 B.R. 9, 18 (Bankr. E.D.N.Y. 1999) ("In general, only a debtor is included within the protective umbrella afforded by the automatic stay that arises pursuant to § 362(a)(1)").[2] Clearly, therefore § 362(a)(1) does not prevent the Tort Victims from continuing their suits against Honeywell.

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[2] Citing the Fourth Circuit in the Dalkon shield case, the First Central Financial court acknowledged that courts have applied § 362(a)(1) to suits against non-debtors in "unusual situations," which arise when "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor[.]" 238 B R. at 18-19 (citing A.H. Robins Co. v. Piccinin (In re A H Robins Co.)), 788 F.2d 994, 999 (4th Cir.), *cert denied*, 479 U.S. 876 (1986); *accord* In re Zale Corp , 62 F.3d 746, 761 (5th Cir. 1995) In the instant case, there is no identity between Debtor and Honeywell. In fact, the parties disagree as to who

Debtor relies heavily upon dictum from *A H Robins Co v Piccinin*, 788 F.2d 994 (4th Cir. 1986) However, the Fourth Circuit made it clear that it would not extend the stay to an independently liable co-defendant, stating "'where the debtor and another are joint tortfeasors or where the nondebtor's liability rests upon his own breach of duty'" the automatic stay "'would clearly not extend to such nondebtor.'" 788 F.2d at 999 (*quoting In re Metal Center, Inc.*, 31 B.R. 458, 462 (Bankr. D. Conn. 1983)). Honeywell's liability in the pending Tort Litigation brought by Reaud, Morgan's clients "rest upon [Honeywell's] own breach of duty." *Id* Ergo, no entitlement to a non-debtor stay.

In *McCartney v. Integra Nat'l Bank N*, 106 F.3d 506 (3d Cir. 1997), a case also relied upon by Debtor, the United States Court of Appeals for the Third Circuit reiterated:

> Although the scope of the automatic stay is broad, the clear language of section 363(a) stays actions only against a 'debtor.' As a consequence, 'it is universally acknowledged that an automatic stay of proceedings accorded by § 362 may not be invoked by entities such as sureties, guarantors, or others with a similar legal or factual nexus to the . . debtor."

Id. at 509-10 (citations omitted).

Moreover, Debtor's reliance on *McCartney* is simply wrong. Debtor's characterization of the case notwithstanding, in *McCartney* the Third Circuit did not uphold "an extension of the automatic stay to claims against a debtor's loan guarantor." *See* Debtor's Memorandum of Law at 19. Rather, in *McCartney*, the Debtor was the guarantor.[3]

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should be responsible for compensating the Tort Victims. *See* Exhibits 2 and 3 to the Debtor's Memorandum and the Declarations of Kreindler and Allegretti, filed in support of the Debtor's Complaint.

[3] In McCartney, the Third Circuit affirmed the denial of summary judgment sought by the debtor that his debt was discharged for a deficiency claim by the lender on a debt McCartney (the debtor) guaranteed The court observed that under applicable state law, to assert a deficiency claim the creditor would have been required to bring a declaratory judgment against both the obligor and the guarantor (the debtor, McCartney) or risk discharging the guarantor from liability. McCartney, 103 F.3d at 510-11. The creditor could not name McCartney in the deficiency action, because to do so would violate the automatic stay *Id.* at 511.

b. *Indemnification alone does not constitute "Unusual Circumstances."*

Debtor relies on *A H Robins. Co v Piccinin*. 788 F.2d 994 (4th Cir. 1986) for the proposition that the automatic stay should be extended to cover non-debtor Honeywell on the basis of the parties' indemnification agreement. However. the Fourth Circuit's statement to that effect in *A.H. Robins* is mere dictum. In fact the United States District Court for the Western District of Pennsylvania has expressly rejected "the dictum stated by the [Fourth] Circuit in A.H. Robins Co., Inc., 788 F.2d at 999-1000, holding a stay permissible under subsection (a)(1) based solely on the existence of an indemnification agreement." *Algemene Bank Nederland v Hallwood Industr., Inc*, 133 B.R. 176, 180 n.3 (W.D. Pa. 1991).

Additionally, the *A.H. Robins* dictum describes "a suit against a third-party who is entitled to absolute indemnity by the debtor on account of any judgment that might result against them in the case." 788 F.2d at 999 (emphasis added). Absolute indemnities often arise by operation of law. For example, many cases which have extended the automatic stay to non-debtors have done so on the basis that the indemnification at issue was one that the debtor was obligated to provide its officers and directors and that a finding of liability of those officers and directors would expose the debtor to liability under the doctrine of respondeat superior *See, e g., American Film Techs., Inc v. Taritero (In re American Film Techs , Inc.)*, 175 B.R. 847, 848-50 (Bankr. Del. 1994).

Here, the indemnification obligations at issue are not absolute but are in dispute. *See* Declaration of Peter M. Kreindler, Esq. of Honeywell International Inc., in Support of Complaint for Declaratory and Injunctive Relief and Motion for a Temporary Restraining Order and for Preliminary Injunction at 4, ¶ 10; Declaration of Jon Allegretti, Esq. of North American

Refractories Company in Support of Complaint for Declaratory and Injunctive Relief and Motion for a Temporary Restraining Order and for Preliminary Injunction at 6, ¶ 17. Clearly, a finding of liability on the part of Honeywell cannot be imputed against Debtor when Honeywell disputes the extent of the limited negotiated indemnities contained in its 1986 Purchase Agreement with the newly-created NARCO.

c. Proceeds of the relevant insurance policies are not property of the estate.

Nor is § 362(a)(3) applicable in this case. Debtor argues that Honeywell's insurance may be better used funding a plan for NARCO than being used to compensate Honeywell's own victims. This is an odd proposition and is irrelevant to 11 U.S.C § 362.

Proceeds of a debtor's liability insurance are property of the estate, as would be the case if, for example, the proceeds were to reimburse Debtor for a loss incurred through a fire or theft. In the seminal case of *In re Louisiana World Exposition, Inc*, 832 F.2d 1391 (5th Cir. 1987), the Fifth Circuit recognized that, though a corporate debtor may have bare ownership of a directors and officers liability policy (making the policy itself property of the estate), the proceeds of such a policy, which redound to the benefit of the directors and officers, are not property of the estate. *Id.* at 1394. The Fifth Circuit emphasized the distinction between owning a policy and owning the proceeds: "[t]he question is not who owns the policies, but who owns the liability proceeds." *Id.* at 1399. Courts have followed this reasoning, recognizing that while a debtor's insurance policy may be property of the estate, whether the proceeds of such policy are property of the estate is an entirely different matter. *See, e.g, In re First Central Financial Corp.*, 238 B.R. 9 (Bankr. E.D.N.Y. 1999); see *also In re Edgeworth*, 993 F.2d 51, 56 (5th Cir. 1993) ("when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate."). But see *Aetna Cas & Sur Co. v. Jasmine, Ltd. (In re Jasmine, Ltd.)*, 258 B.R.

119, 128 (D.N.J. 1999) (where debtor had a preexisting indemnification interest in D & O proceeds, the proceeds could be bought into the estate). Thus, Honeywell's Tort Victims are entitled to Honeywell's insurance proceeds. Because Honeywell has not filed for chapter 11 protection (instead of paying $100 million to NARCO to file for protection), this Court does not have jurisdiction to "protect" its insurance.

The United States Court of Appeals for the Third Circuit held that proceeds of a credit life insurance policy were not property of the estate, because the creditor was the named beneficiary of the policy. *First Fidelity Bank v. McAteer*, 985 F.2d 114, 118-19 (3d Cir. 1993). Because the debtor would not have a right to the proceeds of the policy if the debtor was not in bankruptcy, the proceeds were not property of the estate. *Id* at 117. Similarly, the United States District court for the Eastern District of Pennsylvania has held that proceeds of the debtor's directors and officers liability insurance were not property of the estate, stating "the proceeds of the insurance policy in question are not property of the estate under 11 U.S.C. § 541(a) since debtor does not have a right to receive and keep the proceeds when the insurer pays on the claim . . . ." *In re Pelullo*, No. 98-6181, 1999 U.S. Dist. LEXIS 14920, at * 13 (E.D. Pa. Sept. 29, 1999). In so holding, the *Pelullo* court cited *In re Berger Steel*, 51 B.R. 59,60 (Bankr. N.D. Ind. 1985) in which the court held that liability policies for payment of claims of successful tort plaintiffs were of inconsequential value to the estate and should be abandoned "because the policies could only be accessed by tort claimants' judgments or settlements." *Id.* at *12-13.

3. **<u>This Court may not, pursuant to § 105(a) of the Code, enjoin the Tort Victims from pursuing Honeywell.</u>**

As a general rule, a bankruptcy case does not afford protection from creditors to non-debtors. Section 524(e) of the Code specifically limits the effect of a bankruptcy discharge to the debtor, and, as discussed above, during the pendency of a case § 362(a) provides a stay only of suits *against the debtor* Nevertheless, in rare circumstances, pursuant to § 105(a) of the Code, bankruptcy courts have provided limited protection from suit to non-debtors. Thus, in asking that this Court issue an injunction protecting Honeywell, Debtor seeks relief that is extraordinary and granted only in exceptional circumstances not present here.

Section 105(a) of the Code states that a bankruptcy court may "issue any order ... that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. The federal courts have repeatedly cautioned that §105(a) should be used sparingly; that it does not vest a bankruptcy court with equitable carte blanche; and that, on those occasions when it is employed, it must be used in a manner consistent with the Code as a whole. *See Matter of Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995); *In re Oxford Mgmt., Inc.*, 4 F.3d 1329, 1334 (5th Cir. 1993) ("[T]he powers granted by [§ 105] must be exercised consistent with the Bankruptcy Code" and holding a § 105 injunction to be improper because it purported to alter another provision of the Code); *Matter of Fesco Plastics Corp*, 996 F.2d 152, 154 (7th Cir. 1993); *United States v Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986) (holding that § 105 "does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity"); *In re Western Real Estate Fund, Inc*, 922 F.2d 592, 601 (10th Cir. 1990); *In re Phar-Mor, Inc Securities Litigation*, 166 B.R. 57, 61 (W.D. Pa. 1994) (court must determine "whether the relief requested [under § 105(a)] is contemplated within the Code, or whether such relief would create rights . . . which were heretofore non-existent . . . "); *In re Florida Bay Banks, Inc*. 156 B.R. 673 (Bankr. N.D. Fla. 1993) (statute does not elevate bankruptcy court to "super court" status; court's equitable powers must derive from other Code provisions).

Despite the overwhelming weight of authority cautioning bankruptcy courts against abuse of § 105(a) powers – and despite the clear implication of §§ 362(a)(1) and 524(e) that protecting non-debtors like Honeywell from suit is not contemplated by and is in fact inconsistent with the Code – Debtor suggests various bases on which this Court might stay the Tort Victims from pursuing Honeywell. First, Debtor urges that the Tort Victims claims should be stayed. since, otherwise, liquidation of claims against Honeywell would effect a determination of Debtor's liability. Second, Debtor suggests that those cases staying litigation that would interfere with the reorganization effort are applicable in the instant case. Third, Debtor suggests that "preserving" non-debtor Honeywell's insurance is the proper subject of this Court's jurisdiction. None of these theories supports entry of an injunction in this case.

a. *Judgments against Honeywell by the Tort Victims will not establish Debtor's liability.*

Debtor ominously suggests that it will be bound by judgments rendered against Honeywell if the prosecution of the Tort Litigation were to resume against Honeywell. This argument is a red herring and is wholly unsupported in law. First, Honeywell itself manufactured in the mid-to-late 1960s, whereas Debtor did not even come into existence until 1985. As the cases cited below make clear. indemnitor-indemnitee collateral estoppel under these circumstance simply does not exist.

(i). Federal Courts Look to the Law of the Court that Renders the Judgment to Determine its Preclusive Effect

It is the most basic hornbook law that federal courts honor the res judicata effects of state court judgments. Wright, Miller and Cooper make the point in their treatise:

> More often than not federal and state res judicata rules are the same, and state judgments are honored without need for further explanation. When explanation is

> given, *the general rule is clearly stated: a state court judgment commands the same res judicata effects in federal court that it would have in the court that entered it.* The general rule is so well settled that it is almost as well served by annotation as explanation.

Wright, Miller & Cooper, *Federal Practice and Procedure Jurisdiction* §4469 at p. 659-671 (1981)(emphasis supplied). *See Wright v Georgia*, 216 U.S. 420, 428-9 (1910) ("This Court, as is well settled, accords to a judgment of a State only that effect given to it by the court of the State in which it was rendered.") This doctrine causes no problems, since the Texas and federal law of collateral estoppel (also called "issue preclusion") are virtually identical. The Texas Supreme Court stated in *Sysco Food Services, Inc. v Trapnell*, 890 S.W.2d 796, 801 n.7: "We perceive little difference between the federal courts' formulation of the doctrine [of collateral estoppel] and our own." *See also Eagle Properties, Ltd., v Scharbauer*, 807 S.W.2d 714 (Tex. 1990).

(ii) Texas Follows the General Rule that a Party is Not Bound by a Judgment in an Action in which it was not a party.

Texas follows the general rule that a party against whom the doctrine of collateral estoppel is asserted must have been a party or in privity with a party in the first action. *Sysco Food Services, Inc. v. Trapnell*, 890 S.W.2d 796, 802 (Tex. 1994). While under some circumstances a nonparty may be bound, those circumstances simply do not exist here.

(iii) Debtor does not meet the "Party or Privy" Rule of Texas and Federal Law

Debtor breezily suggests that a Tort Victim's judgment against Honeywell will effectively bind Debtor This is clearly not the case. Because of the automatic stay (unless the stay is lifted), the Debtor will not be a party to the Tort Litigation and will not be bound by any judgment rendered against Honeywell. Thus, collateral estoppel can only apply if Debtor is "in privity" with Honeywell in the Tort Litigation. Privity is a concept that is peculiarly substantive in nature, and federal courts in the collateral estoppel context always defer to state views of privity, even when the first judgment was rendered in a federal court. *See e g., Lowell Staats Mining Co. v. Philadelphia Elec Co.*, 878 F.2d 1271, 1274 (10th Cir. 1989)

The underlying policy behind the privity exception is this: while a party may not have been technically a party to the prior judgment, he is precluded from relitigating because his interest in the prior litigation was "adequately represented" by a party who is so completely aligned with his interest that due process is not offended by denying the estopped party his day in court. *This is never the case where the two parties have a conflict in interest in the outcome of the first litigation* Restatement (Second) Judgments § 57.

An example of this black letter principle is *United Arab Republic of Egypt v. M/V Robert E Lee*, No. 96 Civ. 7170, 1997 U.S. Dist Lexis 10330 (S.D.N.Y. 1997). There, the court noted the impossibility of binding an indemnitor where his indemnitee had a conflicting interest in the prior litigation. The Government of Egypt had bought expensive helicopters in the U.S. and had them shipped by Waterman Steamship Corp., the owner of the Robert E. Lee. Cooper/T.Smith Stevedoring loaded the helicopters in the Port of New Orleans. Waterman had the ship stop in New York, where the cargo was shifted, and Waterman had the ship unloaded in Alexandria, Egypt. When the helicopters arrived damaged in Alexandria, the Egyptian Government sued the steamship company in New York. Cooper, the stevedoring firm was a New Orleans company and could not be joined. Under maritime law, a stevedoring firm owes an unconditional duty to indemnify the shipowner against any loss occasioned by the stevedore's fault.[4]

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[4] *See Saks Int'l, Inc v. M/V "Export Champion"*, 817 F 2d 1011, 1014 (2d Cir 1987, cited in *United Arab Republic of Egypt, supra*

> ...[E]ven if a determination were to be made in this Court as to the amount of damage caused by Cooper's fault, **such determination would not be binding on Cooper in a subsequent litigation, because there exists an inherent conflict of interest between Waterman and Cooper regarding this issue.** This conflict arises because **Waterman has an incentive to argue that the damage to the cargo occurred during loading by Cooper at New Orleans rather than during shifting at New York , since Waterman is entitled to indemnification from Cooper for the former but not the latter.**

United Arab Republic of Egypt, 1997 U.S. Dist. LEXIS 10330. at *11-13 (emphasis supplied).

This is not a hypothetical conflict of interest. It arises as a matter of law. *See* Restatement (Second) Judgments §57, entitled "Effect on Indemnitor of Judgment Against Indemnitee." The Debtor (and even Honeywell) even concede that there is a conflict of interest between them as to who is liable for the Tort Litigation. Listen to what *they* say:

> Since shortly after 1986, Honeywell (then Allied) and NARCO have disputed the scope of their respective indemnity obligations. In a nutshell, NARCO believes Honeywell is responsible for the vast majority of past claims. Honeywell, however, asserts that NARCO is responsible for a material and growing percentage of all NARCO asbestos claims. *See Declaration* of Jon Allegretti, Esq. Of North American Refractories Company, filed in support of Debtor's Complaint at 5, ¶ 14.
>
> In fact, Honeywell threatened and was prepared to pursue litigation against NARCO to resolve and enforce NARCO's obligation to indemnify Honeywell.... *See* Declaration of Peter M. Kreindler, Esq. Of Honeywell International Inc., filed in connection with Debtor's Complaint at 4, ¶ 10.
>
> There is a dispute between Honeywell and NARCO relating to which products are Discontinued Products, the scope of the Honeywell Indemnity, and the respective rights and obligations of Honeywell and NARCO with

> respect to the pending and any future claims arising from the NARCO business. *See* Honeywell/RHI letter dated January 3, 2002 (the "Honeywell Agreement").attached as Exhibit 3 to the Debtor's Memorandum.
>
> There is a dispute between Honeywell and NARCO relating to which products are Discontinued Products, the scope of the Honeywell Indemnity, and the respective rights and obligations of Honeywell and NARCO with respect to the pending and any future claims arising from the NARCO business. *See* NARCO letter to Honeywell dated January 3, 2002, attached as Exhibit 2 to the Debtor's Memorandum.

Thus both Honeywell and Debtor have judicially admitted that there can be no collateral estoppel effect. Like most American jurisdictions and the federal courts, Texas follows Restatement (Second) of Judgments §57. *See, e.g., Benson v Anderson*, 899 S.W.2d 272 (Tex. App.—Houston [14th] 1995, writ denied). The Debtor's collateral estoppel argument is without foundation in Texas and in virtually every jurisdiction in the country. There being a conflict of interest between indemnitor and indemnitee, no judgment obtained against the indemnitee Honeywell will bind the indemnitor NARCO.

b. Pursuit of Honeywell by the Tort Victims will not unduly interfere with Debtor's reorganization efforts.

Finally, Debtor cannot show that pursuit of Honeywell in the Tort Litigation will interfere with its reorganization effort to a degree sufficient to justify an injunction. Injunctive relief is not appropriate simply to protect the Debtor or its agents from limited discovery, which seems to be the only "interference" from which Debtor professes to need protection. As the district court cogently observed in connection with the Johns-Manville bankruptcy:

> . . . I am not persuaded that permitting limited discovery in this or comparable cases would bring about so disruptive an effect upon Manville's reorganization efforts as to condone the imposition of an injustice upon others.

In re Johns-Manville Corp., 41 B.R. 926, 932 (S.D.N.Y. 1984).[5]

This is not a case where the Debtor's officers and directors are so embroiled in litigation relating to Debtor's bankruptcy that they face the prospect of personal financial ruin and the attendant distraction that would divert their energies from the Debtor's reorganization effort. Thus, cases such as *In re Otero Mills, Inc.*, 25 B.R. 1018 (D.N.M. 1982), in which the bankruptcy court had enjoined a bank from proceeding to enforce its judgment against the debtor's president, are readily distinguishable. Injunctive relief is only appropriate to protect a debtor's agents from distractions so serious they might hamper reorganization and thus cause the debtor to suffer irreparably injury; it is not appropriate merely to insulate the debtor from inconveniences that pose no threat of irreparable harm.

Debtor acknowledges its vast experience in defending claims by Tort Victims; it has been named as a defendant by approximately 290,383 plaintiffs since 1983. *See* Declaration of Jon Allegretti, Esq. of North American Refractories Company in Support of Complaint for Declaratory and Injunctive Relief and Motion for a Temporary Restraining Order and for Preliminary Injunction (the "Allegretti Declaration") at 4, ¶ 10. Moreover, the Debtor has had the same asbestos defense counsel for approximately sixteen years. *See* Declaration of Michael D. Heintzman, Esq. in Support of Complaint for Declaratory and Injunctive Relief and Motion for a Temporary Restraining Order and for Preliminary Injunction (the "Heintzman Declaration") at 2, ¶ 2. Indeed, it has become routine for Debtor and its counsel to prepare for "trial on hundreds of asbestos clams each month and sometimes, even within a single week." *Id.* at 5, ¶ 16. Presumably, if the documentary evidence needed to defend NARCO-related asbestos claims has been in Debtor's possession since January 1986, that documentary evidence is already well

[5] Again, if any relief is warranted, it need not and should not be so draconian as that requested by Debtor

organized and readily accessible to Debtor's counsel *Id* at 9, ¶ 25 Thus, the burden on Debtor of providing such documentary evidence to Honeywell would be *de minimus*, if NARCO is required to supply such documents to Honeywell at all.

Debtor has not (and cannot) meet its burden that it will be irreparably harmed if the Tort Victims prosecute their claims against non-debtor Honeywell. Debtor offers only conclusory statements that the burden is "enormous" and the pace "grueling." *See* Allegretti Declaration at 4, ¶ 12. Significantly, Debtor provides no detail to support its conclusion that the burden is "enormous." *See generally* Allegretti Declaration. Similarly, if asbestos litigation proceeds against Honeywell, Debtor's long-time asbestos litigation counsel only "expects there to be little or no change with regard to the demands on NARCO personnel and resources . . ." *See* Heintzman Declaration at 9, ¶ 26. Debtor's litigation counsel provides no evidence to prove the "enormousness" of those demands. *See generally* Heintzman Declaration. Indeed, Debtor concedes that some of the witnesses "essential" to Honeywell's defense of asbestos claims are not current employees of the Debtor. *See* Allegretti Declaration at 10, ¶ 26.

In fact, the primary concern expressed by Debtor's asbestos litigation counsel is that, absent extensions of the stay to non-debtor Honeywell, "there likely will be an immediate attempt by plaintiffs to proceed with a number of short-term trials against Honeywell." *See* Heintzman Declaration at 10, ¶ 28. However, "[t]he Code is designed to eliminate a 'race to the courthouse' by creditors seeking to file claims against a debtor. Here, any 'race' that may occur would be for the purpose of lodging claims against a non-debtor, which is not a bankruptcy concern." *Phar-Mor, Inc v General Elec. Capital Corp (In re Phar-Mor, Inc. Sec. Litig)*, 166 B.R. 57, 62 (W.D. Pa. 1994) (denying debtors' motion for preliminary injunction to enjoin actions against debtors' former certified public accounting firm). Accordingly, Debtor has not met its burden of proof to entitle it to obtain the extraordinary remedy it seeks for the benefit of non-debtor Honeywell.

c. Cases protecting inadequate insurance are inapposite.

Injunctive relief prohibiting the Tort Victims from continuing their suit against Honeywell is neither necessary nor appropriate. Here Debtor does not claim any interest in insurance policies. It is Honeywell that is apparently entitled to coverage under its insurance policies, and not NARCO. This is not a co-insurance or shared insurance situation: the insurance is Honeywell's, not NARCO's. But even if this were viewed as a co-insurance case, no injunction would be warranted. In *In re Vitek, Inc*, 51 F.3d 530 (5th Cir. 1995), the Fifth Circuit rejected the notion that non-debtors who shared insurance coverage with a debtor were entitled to such protection. *Vitek* involved product liability suits against the debtor corporation (Vitek) and its directors/officers (the Homsys). The bankruptcy court authorized a settlement between Vitek's bankruptcy trustee and its liability insurance carriers. *Id.* at 531. Suits against the insurers were to be enjoined in exchange for payment of the remainder of policy limits into Vitek's estate for the benefit of creditors. *Id.* The Homsys objected because they "were to be enjoined from suing the carriers, but they would not themselves be protected from third party suits." *Id* at 532. On appeal, the district court reversed and remanded to the bankruptcy court, instructing "that court to extend its injunction to cover" the Homsys. *Id.* On further appeal, the Fifth Circuit reversed, declining to require extension of the injunction to the Homsys and modifying the injunction only to provide that the Homsys could sue the insurers for breach of good faith.[6]. *Id.* at 537-38. The Court said:

[6] The Fifth Circuit took no position on the question of whether the applicable law (that of Texas) even recognized such a cause of action under the circumstances of the case. *Id.* at 538

> We wonder "out loud" about the extent, if any, to which the tools of injunctive relief . . . are appropriate – not only in dealing with the interests of co-insureds in policy proceeds, but also in dealing with the rights of third party creditors of the bankruptcy and non-bankrupt debtors . . .. The broad latitude afforded bankruptcy courts in fashioning remedies should not be used in a way that tramples on the rights of . . . non-parties to the proceedings.

Id. at 538, n.39. The Fifth Circuit thus rejected the notion that the Homsys, who shared insurance coverage with a debtor, were entitled to protection under the bankruptcy laws.

Furthermore, in cases involving an insurance pool, injunctive relief may be considered "necessary or appropriate" only if the pool is *inadequate* to satisfy the claims against it. For example, in *In re Spaulding Composites, Co*, 207 B.R. 899 (Bankr. 9th Cir. 1997), the debtor, Spaulding, faced environmental exposure. Liberty, an insurer, had issued policies to Spaulding and Spaulding's two corporate shareholders, Nortek and Monogram.

After Spaulding filed bankruptcy, Liberty filed suit against Nortek and Monogram, neither of which was in bankruptcy, seeking declaratory relief concerning its liability under the policies. Spaulding's creditors' committee then filed an adversary complaint against Liberty seeking to enjoin further prosecution of Liberty's suit. The bankruptcy court ruled that Liberty's suit was void as a stay violation. The Bankruptcy Appellate Panel reversed and held that Liberty's coverage suit neither violated the stay nor threatened estate property, noting that "nothing in the record indicate[d that] fulfilling the duty owed to Nortek or Monogram would impair Liberty's ability to satisfy its obligations to Spaulding or increase Spaulding's liability exposure." *Id* at 907.[7]

---

[7] Cases upholding injunctive relief often involve direct action suits against the insurers – as opposed to suits against co-insureds. *See, e g*, In re Davis, 730 F.2d 176 (5th Cir 1984) In either situation, however, if coverage is adequate for the claims, a suit against a non-debtor will not impact the debtor's estate or reorganization effort so as to make injunctive relief "necessary or appropriate to carry out the provisions of" the Code.

Ultimately, relief is "necessary or appropriate" only if Debtor can show a substantial threat of irreparable injury to *itself* – not to Honeywell. Only if Honeywell itself with a $26 billion market capitalization were judgment proof – an incredible notion – could Debtor even conceivably be "irreparably injured" by reason of exhaustion of Honeywell's insurance coverage.

IV. CONCLUSION

Debtor instituted this adversary to prevent the Tort Victims from pursuing Honeywell. The automatic stay, § 362(a)(1) and (3), is unavailing because the Tort Victims propose to pursue Honeywell -- not Debtor, or even insurance coverage that Honeywell apparently claims it is willing to share with Debtor. If Debtor is concerned about Honeywell depleting coverage under Honeywell's insurance policies, its quarrel is with Honeywell, not the Tort Victims. Similarly, Debtor's invocation of § 105(a) is defeated by the very the facts it has presented the Court under oath. Because of the conflict of interest between Honeywell and NARCO, the Tort Victims' pursuit of Honeywell will not establish Debtor's liability. As a matter of law, it cannot.

Inasmuch as Debtor is not entitled to the relief sought in its Complaint under 11 U.S.C. §§ 362(a) and 105(a) and has therefore failed to state a claim on which relief can be granted, the Complaint should be dismissed. The Tort Victims respectfully pray that their Motion be granted and that the Complaint be dismissed.

Respectfully submitted.

BERNSTEIN LAW FIRM, P.C.

By: ______________________
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ATTORNEYS FOR
REAUD, MORGAN & QUINN, INC

RHI
Refractories
AMERICA

January 3, 2002

Honeywell International Inc.
101 Columbia Road
Morristown, New Jersey 07962

Gentlemen:

North American Refractories Company ("NARCO") is a wholly-owned subsidiary of RHI Refractories Holding Company, a Delaware corporation ("RHI"). Prior to January 17, 1986, NARCO was an unincorporated division of a predecessor to Honeywell International Inc. ("Honeywell").

In 1986, in connection with the sale of the NARCO business, Honeywell agreed to indemnify NARCO, with certain exceptions, for any liability associated with asbestos-containing products manufactured and sold by the NARCO business prior to January 17, 1986 and that constituted "Discontinued Products" as defined in the agreement granting the indemnity, as such indemnity has been amended to date (the "Honeywell Indemnity").

NARCO is the defendant in numerous personal injury actions related to (a) Discontinued Products, (b) NARCO products that were continued after January 17, 1986, and (c) NARCO products manufactured and sold for the first time after January 17, 1986, and NARCO expects similar actions to be filed in the future (the "NARCO Actions"). Honeywell is also a defendant in some of the NARCO Actions.

There is a dispute between Honeywell and NARCO relating to which products are Discontinued Products, the scope of the Honeywell Indemnity, and the respective rights and obligations of Honeywell and NARCO with respect to the pending and any future claims arising from the NARCO business.

Prior to January 1, 2001, Honeywell and NARCO by agreement shared in the costs of the defense and/or settlement of all cases. NARCO's obligation to make certain payments in connection with the Honeywell Indemnity is hereinafter referred to as the "NARCO Contribution." Honeywell contends that since January 1, 2001, NARCO has not performed its obligations with respect to the NARCO Contribution, and NARCO contends that it has a claim for an overpayment of the NARCO Contribution for years prior to 2001.

EXHIBIT
A

Notwithstanding this dispute, with a full reservation of rights since January 1, 2001, Honeywell has undertaken the defense of all personal injury actions filed against NARCO, including those that allege liability arising out of the manufacture and sale of products that Honeywell believes are not covered by the Honeywell Indemnity

Honeywell no longer is prepared to undertake the entire defense of the NARCO Actions that Honeywell does not believe are covered by the Honeywell Indemnity, and Honeywell intends to seek contribution from NARCO, RHI and others with respect to such liability for cases in which NARCO has not performed its obligations with respect to the NARCO Contribution.

Nothing contained in this letter agreement shall be an admission against any other party with respect to such dispute, and all rights of each party are expressly preserved.

Concurrently herewith, Honeywell is entering into a letter agreement (the "NARCO Agreement") with NARCO regarding, inter alia, debtor-in-possession financing for NARCO in the NARCO Chapter 11 Case (as hereinafter defined).

Honeywell and RHI have each been advised by counsel with respect to the execution and delivery of this letter agreement, and in the exercise of the fiduciary obligations of each party. From and after this date, the board of directors of Honeywell and RHI shall continue to exercise independent fiduciary duties with respect to the actions contemplated to be taken hereby and in connection with the NARCO Agreement and NARCO.

In furtherance of the foregoing, the parties intend that all actions taken in the NARCO Chapter 11 Case (as hereinafter defined) pursuant to this letter agreement will, to the extent required by the Bankruptcy Code, be subject to the Bankruptcy Court's approval and shall be consistent with the requirements of the Bankruptcy Code and other applicable law. In particular, the terms of this letter agreement shall be disclosed to the Bankruptcy Court in connection with NARCO's first-day motion seeking approval of the DIP Commitment (as hereinafter defined).

On the terms and subject to the conditions set forth herein, Honeywell and RHI hereby agree as follows:

1. On the terms and subject to the conditions of the NARCO Agreement, Honeywell or an affiliate is prepared to provide NARCO with a $20 million commitment for debtor-in-possession financing (the "DIP Commitment") In the event that Honeywell funds the DIP Commitment through an affiliate, Honeywell shall provide RHI with reasonable assurance that such affiliate will be able to perform its financial obligations with respect to the DIP Commitment.

2 A. If, on or about January 4, 2002, NARCO files a petition for relief (the "Petition") under Chapter 11 of the Bankruptcy Code (the "Chapter 11 Case") in the United States District Court for the Western District of Pennsylvania (the "Bankruptcy Court"),

Honeywell shall upon filing of the Petition, pay to RHI by wire transfer of immediately available funds the sum of $40 million.

2.B. If NARCO complies with its obligations under the NARCO Agreement after the filing of the Petition to seek, by means of an adversary proceeding in form and substance satisfactory to Honeywell, an injunction under Sections 362 and 105 of the Bankruptcy Code to stay any litigation against Honeywell arising out of the NARCO business (the "Honeywell Actions"); and if Honeywell decides to remove any or all present or future Honeywell Actions to federal courts, NARCO cooperates with Honeywell in seeking such removal, and in such event, NARCO seeks to consolidate all such actions in the United States District Court in which the Chapter 11 Case is pending, then upon (1) NARCO's filing of a plan of reorganization (the "Plan") that is acceptable to Honeywell in its sole discretion, pay to RHI $20 million by wire transfer of immediately available funds, and (2) confirmation and consummation of a Plan that is acceptable to Honeywell in its sole discretion, pay to RHI the additional sum of $40 million by wire transfer of immediately available funds.

2.C. Upon the commencement of the NARCO Chapter 11 Case, Honeywell shall provide RHI with a clean irrevocable standby letter of credit (1) in the amount of $20 million that may be drawn by RHI in the event that Honeywell fails to make payment in accordance with paragraph 2(B) (1) above, and (2) in the amount of $40 million that may be drawn by RHI in the event that Honeywell fails to make payment in accordance with paragraph 2(B)(2) above.

2 D. For the avoidance of doubt, a Plan that provides (v) for a channeling injunction pursuant to Section 524(g) of the Bankruptcy Code in form and substance satisfactory to Honeywell in its sole discretion that enjoins any future litigation against Honeywell or any affiliate (or any insurer thereof) in respect of the NARCO Actions and the Honeywell Actions, (w) that Honeywell shall retain sole and absolute discretion and approval with respect to the amount and timing of any payment or other contribution to the Plan made by or on its behalf, (x) Honeywell with sole and absolute discretion and approval with respect to any other aspect of the Plan that affects Honeywell in respect of the NARCO Actions or any claims of Honeywell in any material respect, (y) that RHI shall cause the contribution to the trust contemplated to be created thereunder of the Capital Stock (as hereinafter defined) of NARCO and (z) for the cancellation of any debt that RHI or any non-United States Affiliate (as hereinafter defined) of RHI holds in NARCO, shall be a Plan acceptable to Honeywell in its sole and absolute discretion. For purposes hereof, "Affiliate" means a Person (as hereinafter defined) who controls, is controlled by, or is under common control with, any other Person

3. RHI represents, covenants and warrants to Honeywell as follows:

3.A. The authorized capital stock of NARCO consists of 100,000shares of common stock, with no par value of which 57,474 shares are issued and outstanding, and all of which are held beneficially and of record by RHI, and 30,000 shares of preferred stock, par value of $100.00 per share, 30,000 shares of which are issued and outstanding and held of record by RHI, and no other class of capital stock (the "Capital Stock"). There are no outstanding options, warrants, rights or other securities convertible or exchangeable into shares of Capital Stock, and no person, firm, corporation or other entity (collectively, a "Person") has any pre-emptive or contractual rights to acquire shares of Capital Stock.

3.B. The Capital Stock of NARCO is held by RHI free and clear of any lien, claim, charge of encumbrance (collectively, "Liens"). Until the first to occur of: (1) a plan of reorganization for NARCO shall have been confirmed by the Bankruptcy Court or (2) the NARCO Chapter 11 Case shall have been dismissed or converted to a proceeding under Chapter 7 of the Bankruptcy Code, RHI will not (x) sell, assign, transfer or convey any shares of Capital Stock to any Person, or (y) grant a Lien upon any shares of Capital Stock to any Person or suffer to exist any Lien thereon.

3.C. RHI owns approximately $59.4 million principal amount of claims against NARCO. Except for claims held by Global Industrial Technologies, Inc. and its subsidiaries, no Affiliate of RHI holds any claims against NARCO.

4. In the event that (a) either RHI shall fail to fulfill any of its obligations hereunder or under the NARCO Agreement or NARCO shall fail to fulfill any of its obligations under the NARCO Agreement, or (b) a NARCO Termination Event shall occur (as such term is defined in the NARCO Agreement), Honeywell may in the exercise of its sole discretion, by delivering written notice to RHI, terminate its obligation to make any further payments to RHI hereunder. In the event that Honeywell elects to terminate its obligations to make any further payments to RHI, RHI shall be under no obligation to refund or repay any amounts paid to it by Honeywell prior to the date of such termination, but nothing contained in this paragraph 4 shall affect or limit NARCO's obligations under the DIP Commitment, which shall be governed solely by the definitive documentation evidencing such DIP Commitment and any related orders of the Bankruptcy Court.

5. This letter agreement shall be governed by the laws of the State of New York without regarding to its principles of conflicts of laws.

6. This letter agreement may be executed in two or more counterparts, each of which shall be deemed an original, but which together shall constitute one and the same instrument.

7. This letter agreement sets forth all of the promises, covenants, agreements, conditions, and undertakings between the parties hereto with respect to the subject matter hereof and supersede all prior and contemporaneous agreements and understandings, inducements, or conditions, express or implied, oral or written.

This letter agreement may not be amended except by an instrument in writing signed by the party sought to be charged with effect of such amendment.

[SIGNATURES ON FOLLOWING PAGES]

If the foregoing accurately reflects your understanding of the terms of the settlement agreement between Honeywell and RHI, kindly execute the enclosed copy of this letter agreement and return it the undersigned via fax and overnight mail.

Sincerely,

RHI REFRACTORIES
HOLDING COMPANY

By:______________________________
Name:
Title:

Agreed and accepted, this
__ day of January, 2002.

HONEYWELL INTERNATIONAL INC

By:______________________________
Name:
Title:

If the foregoing accurately reflects your understanding of the terms of the settlement agreement between Honeywell and RHI, kindly execute the enclosed copy of this letter agreement and return it the undersigned via fax and overnight mail.

Sincerely,

RHI REFRACTORIES
HOLDING COMPANY

By:____________________
Name:
Title:

Agreed and accepted, this
___ day of January, 2002

HONEYWELL INTERNATIONAL INC.

By:____________________
Name:
Title:

If the foregoing accurately reflects your understanding of the terms of the settlement agreement between Honeywell and RHI, kindly execute the enclosed copy of this letter agreement and return it the undersigned via fax and overnight mail

Sincerely,

RHI REFRACTORIES
HOLDING COMPANY

By:
Name:
Title:

Agreed and accepted, this
4th day of January, 2002.

HONEYWELL INTERNATIONAL INC

By: Peter M. Kreindler
Name: PETER M. KREINDLER
Title: SR VP & GEN'L COUNSEL

CERTIFICATE OF SERVICE

The undersigned certifies that on this 15th day of January. 2002, a true and correct copy of the above and foregoing was served via telecopy on the following persons:

Robert S. Bernstein

W \mek\Motion\NARCO3 doc

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CASE NO. 02-20198

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See CD

For Balance

Of

Documents

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

In re: NORTH AMERICAN REFRACTORIES, COMPANY, ET AL. Debtors.	)	In Proceedings for a Reorganization under Chapter 11 Case No. 02-20198
NORTH AMERICAN REFRACTORIES, COMPANY, ET AL. Movant, v. (NO RESPONDENT)	)	Motion No. 02-0118

OBJECTIONS OF REAUD, MORGAN & QUINN TO MOTION OF DEBTORS FOR AUTHORITY TO (1) OBTAIN POST-PETITION FINANCING, (2) GRANT LIENS AND ADMINISTRATIVE EXPENSE STATUS, AND (3) ENTER INTO AGREEMENT WITH HONEYWELL AND SUPPORTING MEMORANDUM OF LAW

TO THE HONORABLE JUDITH K. FITZGERALD,
UNITED STATES BANKRUPTCY JUDGE:

Reaud, Morgan & Quinn ("Reaud, Morgan") attorneys of record for numerous personal injury plaintiffs (the "Tort Victims") in pending cases against Debtor North American Refractories Company and Honeywell International, Inc., ("Honeywell") respectfully files these Objections to the Motion of Debtors for Authority to (1) Obtain Post-Petition Financing, (2) Grant Liens and Administrative Expense Status and (3) Enter into Agreement with Honeywell (the "DIP Financing Motion") and Supporting Memorandum of Law.

I.

PRELIMINARY STATEMENT

The Debtors' motion should be denied because its effect would be a complete transfer of all control over this reorganization process to a single insider creditor – Honeywell. Honeywell will obtain control of the Debtors' management and will have a veto power over any plan of reorganization. If Honeywell does not get the reorganization plan it wants in this case, it will be able to foreclose on the Debtors' assets and succeed to the ownership of all of the assets of Debtors before this reorganization case is concluded. There is absolutely no question that the proposed transaction is intended to primarily benefit Honeywell. The binding terms of the transaction will amount to a *sub rosa* plan of reorganization, the terms of which have been dictated by Honeywell. The Debtors' do not appear to need financing. their assets are currently unencumbered, they have not heretofore needed secured financing, and their parent company has already received $40,000,000 in cash from Honeywell for causing these Debtors to file this case.

This case is only one month old, but its reorganization purpose will in essence be substantially, if not completely, finished if the financing arrangement that Honeywell seeks is approved. The motion is not proposed in good faith by the Debtors, and it is not fair and reasonable to the creditors in this case. As the authorities presented below demonstrate, similar attempts to leverage the bankruptcy process have been tried in other cases and have not been allowed. Honeywell's attempt to seize control of the Debtor and its reorganization should likewise be denied.

II.

PROCEDURAL BACKGROUND

1. On January 4, 2002 the Debtors commenced their respective reorganization cases by filing voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code").

2. The Debtors are continuing in possession of their respective properties and are operating and managing their businesses, as debtors in possession, pursuant to sections 1107 and 1108 of the Bankruptcy Code.

3. On January 4, 2002, the Debtors filed the DIP Financing Motion. Pursuant to the DIP Financing Motion, the Debtors sought the Court's authorization to obtain post-petition financing pursuant to the Debtor-In-Possession Credit Agreement dated January 4, 2002 (the "DIP Credit Agreement") and related financing documents (collectively, the "DIP Loan Documents") of up to the principle amount of $20,000,000.00 (the "Honeywell Loan") from an affiliate of Honeywell, Jan 2002 Funding LLC ("Honeywell Lender"), with JPMorgan Chase Bank ("Chase") acting as "Administrative Agent."

4. On or about January 4, 2002, the Court held an interim hearing on the DIP Financing Motion and on January 9, 2002, the Court signed an interim order (the "Interim Order") authorizing and empowering the Debtors to execute and deliver the DIP Loan Documents and to borrow an aggregate amount of $5,500,000.00, with the remaining balance to be authorized after a final hearing.

III.

OBJECTIONS

1. Reaud, Morgan objects to the proposed Honeywell Loan because it allows the proposed Honeywell Lender to seize control of the reorganization process. *See, e.g.*, DIP Credit Agreement at 52, Article 8.21 (plan of reorganization must be acceptable in form and substance to Honeywell Lender); and 55, Article 9.01(r) (it is an event of default if any plan of reorganization proposed after the exclusivity period is unsatisfactory to Honeywell Lender in its sole discretion).

2. Reaud, Morgan objects to the proposed Honeywell Loan because the DIP Credit Agreement provides that it is an event of default if any injunction against the prosecution of any asbestos related claims against Honeywell ceases to be in full force and effect or is vacated, stay, reversed, modified or amended by action of the borrower or its affiliates. *See* DIP Credit Agreement at 55, Article 9.01(n).

3. Reaud, Morgan objects to the proposed Honeywell Loan because the DIP Credit Agreement provides that it is an event of default if a trustee or examiner is appointed and such provision may not be in the best interest of the estate and precludes parties in interest from seeking redress for fraud or gross mismanagement. *See* DIP Credit Agreement at 54, Article 9.01(f).

4. Reaud, Morgan objects to the proposed Honeywell Loan because the DIP Credit Agreement provides that it is an event of default if the exclusivity period is terminated and a plan of reorganization is proposed that is unsatisfactory to the Honeywell Lender in its sole discretion. *See* DIP Credit Agreement at 55, Article 9.01(r).

5. Reaud, Morgan objects to the proposed Honeywell Loan because the DIP Credit Agreement provides that the Honeywell Lender may realize on the DIP Collateral (all property and property interests now owned or hereafter acquired by Debtors) with only five business days' notice to the United States Trustee and any statutory committee of unsecured creditors. *See* DIP Credit Agreement at 56, Article 9.02.

6. Reaud, Morgan objects to the proposed Honeywell Loan because the DIP Credit Agreement provides a ninety day cure period for only three specified events of default and presumably no cure period whatsoever for any other event of default. *See* DIP Credit Agreement at 56, Article 9.02 and 14 (defining Matured Specified Event of Default).

7. Reaud, Morgan objects to the proposed Honeywell Loan because the DIP Credit Agreement provides an improper, overbroad, unlimited indemnity to Honeywell, the Honeywell Lender and an untold number of their affiliates. *See* DIP Credit Agreement at 58, Article 10.03.

8. Reaud, Morgan objects to the proposed Honeywell Loan because it impermissibly skews the bankruptcy process in favor of the Honeywell Lender to the detriment of the Tort Victims and other creditors.

9. Reaud, Morgan objects to the proposed Honeywell Loan because the terms of the transaction are not fair, reasonable and adequate, given the circumstances of the Debtors and the proposed Honeywell Lender. This objection is also to the fees the Honeywell Lender proposes to charge Debtors, commencing with a fixed $500,000 administrative fee and a $100,000 per year annual fee.

10. Reaud, Morgan objects to the proposed Honeywell Loan because it is not proposed in good faith.

11. Reaud, Morgan objects to the proposed Honeywell Loan because the Debtors have not made the requisite showing that other credit is unavailable.

IV.

ARGUMENT AND AUTHORITIES

A. The DIP Credit Agreement Is Insider Financing Structured For The Benefit Of The Insider — Honeywell.

1. The DIP Credit Agreement is between the Debtors and an insider.

The financing proposed in the DIP Credit Agreement is actually being provided by Honeywell. *See* DIP Financing Motion at 5, ¶ 21. A review of the pre-petition agreements between Honeywell and NARCO and its affiliates demonstrates that Honeywell controls the Debtors. Honeywell's approval of NARCO's chapter 11 petition and other "first day" pleadings was required, NARCO agreed to file an adversary proceeding to seek an injunction to stay litigation against Honeywell, and any plan of reorganization must be approved by Honeywell. *See* Exhibit B to the DIP Financing Motion at 3 (the "NARCO Agreement"). Accordingly, Honeywell [the actual lender] is an insider within the meaning of 11 U.S.C. § 101(31). 11 U.S.C. 101(31)(B)(iii) ("if the debtor is a corporation . . . person in control of the debtor").

Honeywell's control of the Debtors is beyond dispute. "Control is to be determined by an examination of the facts and particularly whether or not the facts indicate an opportunity to self-deal or exert more control over the Debtor's affairs than is available to other creditors." *ABC Elec. Servs., Inc. v. Rondout Elec., Inc. (In re ABC*

Elec. Servs., Inc.), 190 B.R. 672, 675 (Bankr. M.D. Fla. 1995). Because the NARCO Agreement and the DIP Credit Agreement give Honeywell and the Honeywell Lender the *exclusive* right to control the Debtors' reorganization (to the *exclusion* of other creditors), they establish the "opportunity to self-deal" and a level of control over the Debtors that far exceeds, and even displaces, the control of any other creditors.

2. **The incentive and opportunity for an insider to take advantage in a transaction warrants special scrutiny.**

Because there is an incentive and an opportunity to take advantage, insiders' loans in bankruptcy are subject to special scrutiny. *Crook v. Steel, In re Charles Crook Wholesale Produce*, No. 91-1829, 1993 U.S. App. LEXIS 23539, at *3 (4th Cir. Sept. 14, 1993) (". . . because there is incentive and opportunity to take advantage, dominant shareholders and other insiders' loans in a bankruptcy situation are subject to special scrutiny."); *In re C.E.N., Inc.*, 86 B.R. 303, 306 (Bankr. D. Me. 1988) ("Transactions between debtor and Noyes, clearly an insider under section 101(30)(B), are 'subject to greater scrutiny than "arms length" transactions . . . .'") (citations omitted). Because the proposed Honeywell Lender here is an insider, the DIP Credit Agreement is subject to special scrutiny.

B. **The Debtors Have Not Met The Requirements For Obtaining Credit Under 11 U.S.C. § 364(c).**

1. **The initial three prong test.**

To obtain credit pursuant to 11 U.S.C. § 364(c), the Debtors must show:

(1) They cannot obtain credit unencumbered by super-priority status;

(2) The credit transactions are necessary to preserve assets of their respective estates; and

(3) The terms of the credit agreements are fair, reasonable, and adequate.

In re Crouse Group, Inc., 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987). A motion for credit under 11 U.S.C. § 364(c) should be denied if the debtors fail to establish each of the three required elements. *Id.* at 550. This transaction clearly does not satisfy these elements. Typical, non-insider DIP lending institutions do not require the clearly onerous provisions which the Honeywell Lender demands (control over injunctions, control over exclusivity, control over management, control over plan proposals, control over confirmation).

2. **<u>The terms of the DIP Credit Agreement are not fair and reasonable.</u>**

Even when all of the other prongs required for extending credit under 11 U.S.C. § 364 are met, the Court must also find that the terms of the credit arrangement are fair and reasonable:

> [C]ourts have focused their attention on **proposed terms that would tilt the conduct of the bankruptcy case; prejudice, at an early stage, the powers and rights that the Bankruptcy Code confers for the benefit of all creditors**; or leverage the Chapter 11 process by preventing motions by parties-in-interest from being decided on their merits.

Ames Dept. Stores, 115 B.R. at 37 (emphasis added).

"[A] proposed financing will not be approved where it is apparent that the purpose of the financing is to benefit a creditor rather than the estate." *Id.* at 39. Similarly, a proposed financing should not be approved where it allows the lender to "seize control of the reins of reorganization, and steal a march on other creditors in numerous ways" and allows the lender to "have the ultimate say over the very goal of this Chapter 11 case, a confirmed plan of reorganization." *In re Tenney Village Co.*, 104 B.R. 562 568 (Bankr. N.H. 1989) (denying debtor's motion for approval of financing agreement).

a. **<u>The DIP Credit Agreement allows Honeywell to seize control of the reorganization process.</u>**

Honeywell has indisputably seized control of this reorganization. For example, if the Debtors in the exercise of their fiduciary duties to *all* creditors, including the Tort Victims, is successful in resisting an injunction staying litigation against Honeywell, it is an event of default under the proposed Honeywell Loan. *See* DIP Credit Agreement at 55, Article 9.01(n). If that default is not cured (along with most other defaults), all of Debtors' property within ninety days, the Honeywell Lender can realize on the DIP Collateral (or interests in property now owned or hereafter acquired) on five business days' notice to the United States Trustee and any statutory committee of unsecured creditors. *See* DIP Credit Agreement at 56, Article 9.02.

The level of control is staggering: the Honeywell Lender must approve "[a]ll 'first day orders' and other orders entered by the Bankruptcy Court . . . ." *See* DIP Credit Agreement at 28, Article 4.01(a)(i). In fact, the Honeywell Lender has the ultimate say over the Debtors' plan of reorganization. *See* DIP Credit Agreement at 52, Article 8.21 (plan of reorganization must be "in form and substance acceptable to the Lender").

If Honeywell has its way, it would be an event of default if a trustee or examiner is appointed, *see* DIP Credit Agreement at 54, Article 9.01(f), allowing Honeywell effectively to control the Bankruptcy Court's ability to protect the estate and its creditors from exactly the type of insider dealing that appears to be present here. Courts routinely throw out such provisions because "[s]uch entrenchment of management may not be in the best interests of the estate and only precludes parties-in-interest from seeking to redress fraud or gross mismanagement through such an appointment." *Ames Dept.*

Stores, 115 B.R. at 38. These "entrenchment of management clauses ***skew the carefully designed balance of debtor and creditor protections that Congress drew in crafting Chapter 11.*** " *Id (emphasis supplied).*

But Honeywell demands even more: it is an event of default if the Debtors do not retain exclusivity and a subsequent plan of reorganization is proposed (by anyone, including the Debtors) that is unsatisfactory to the proposed Honeywell Lender— in its sole discretion. *See* DIP Credit Agreement at 55, Article 9.01(r). A clearer example of a "skewed" bankruptcy reorganization would be difficult to conceive.

b. <u>The DIP Credit Agreement prejudices the rights of other creditors.</u>

The Honeywell Loan would allow the Honeywell Lender to obtain immediate repayment upon the maturity of the obligations "(whether by acceleration or otherwise)" — "[n]otwithstanding the provisions of Section 362 of the Bankruptcy Code." *See* DIP Credit Agreement at 38, Article 5.01(v)(v). The entire estate is held hostage to the Honeywell Lender's draconian demands. Incredibly, upon an event of default, the Honeywell Lender can swoop down on ***"all property interests now owned or hereafter acquired by Debtors" with only five business days' notice*** to the United States Trustee and any statutory committee of unsecured creditors. *See* DIP Credit Agreement at 56, Article 9.02. Moreover, there apparently is ***no*** opportunity to cure unless the default is one of three specified events of default. *See* DIP Credit Agreement at 14, Article 1.01 (defining Matured Specified Event of Default) and 56, Article 9.02. Coupled with the prohibition of the appointment of a trustee, these "loan" provisions effectively strip away the ability of the Bankruptcy Court to protect creditors.

In denying a motion for approval of a *similar* post-petition financing arrangement, one court characterized the proposed financing transaction as follows:

> ***Under the guise of financing a reorganization, the [lender] would disarm the Debtor of all weapons usable against it for the bankruptcy estate's benefit, place the Debtor in bondage working for the [lender], seize control of the reins of reorganization, and steal a march on other creditors in numerous ways.*** The Financing Agreement would ***pervert*** the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit of the [lender] and the Debtor's principal who guaranteed its debt. ***It runs roughshod over numerous sections of the Bankruptcy Code.***

Tenney Village, 104 B.R. at 568 (emphasis added). Because the DIP Credit Agreement "pervert[s]" the reorganization process and "runs roughshod over numerous sections of the Bankruptcy Code" to the detriment of the Tort Victims and other creditors, by definition it is not fair and reasonable.

3. **The Debtors have not shown that less onerous post-petition financing is unavailable.**

For the Debtors to demonstrate that they are unable to obtain such credit otherwise, "there is no duty to seek credit from every possible lender." *In re Snowshoe Co., Inc.*, 789 F.2d 1085, 1088 (4th Cir. 1986). However, the Debtors are required "*to make an effort* to carry the burden established in Section 364(d)." *Reading Tube Indus.*, 72 B.R. at 332-33 (denying debtor's motion for refinancing, finding: "The debtor, in the case at hand, has failed to demonstrate that they have approached even one institution to request refinancing. . . .The debtor has been given every opportunity to show even minimal effort in seeking credit. It has chosen not to do so and its failure compels this court to deny the debtor's motion pursuant to Section 364(d)(1)(a).").

"The first prong [of the applicable legal test] requires the debtor to demonstrate that less onerous post-petition financing was unavailable." *In re Reading Tube Indus.*, 72 B.R. 329, 332 (Bankr. W.D. Pa. 1987). The Debtors here cannot seriously say that they sought outside financing. They offer only an unsupported, conclusory statement that they "are unable to obtain credit on any more favorable basis than that offered by the DIP Lender under the DIP Credit Agreement." *See* Debtors' DIP Financing Motion at 9, ¶ 29. The Debtors have not disclosed how many lending institutions they have approached, if any. *Cf. In re Crouse Group*, 71 B.R. at 550 ("First, we are not convinced that the Debtors have made the requisite exhaustive unsuccessful efforts to obtain credit on terms in accordance with § 364(b). Only one lending institution was approached.") In fact, the Debtors state unequivocally that "[p]rior to the Filing, ***the Debtors were able to operate their business without a line of credit or any other type of secured financing[,]*** " *see* DIP Financing Motion at 5, ¶17 (emphasis added). There is no doubt that credit on more favorable terms than those proposed in the Honeywell Loan (with its extraordinary control provisions) ***were*** available. But the Debtors did not aggressively look for it (if they looked at all) because they had concocted a reorganization scheme with Honeywell.

4. **The proposed Honeywell Loan is not necessary to protect the assets of the Debtors' estates.**

The Debtors acknowledge that "[p]rior to the Filing, the Debtors were able to operate their business without a line of credit or any other type of secured financing." *See* DIP Financing Motion at 5, ¶ 17. Moreover, "except for nominal financed equipment, the Debtors' property is unencumbered." *See* DIP Financing Motion at 5, ¶ 18. The Debtors have provided no explanation of why a transaction so heavily weighted in favor of Honeywell is necessary.

Moreover, Honeywell has already paid RHI Refractories Holding Company ("RHI"), Debtors' parent $40,000,000 for the filing of this chapter 11 case:

> 2.A. **If, on or about January 4, 2002, NARCO files a petition of relief (the "Petition") under Chapter 11** of the Bankruptcy Code (the "Chapter 11 Case") in the United States District Court for the Western District of Pennsylvania (the "Bankruptcy Court"), **Honeywell shall upon filing of the Petition pay to RHI by wire transfer of immediately available funds the sum of $40,000,000.**

See Exhibit C to DIP Financing Motion at 2-3. There is no reason that RHI cannot lend the Debtors the money necessary to meet their operating expenses and continue operating their businesses during the pendency of this case. Why mortgage the Debtors, their assets, the creditors, and the Bankruptcy Code's protections for $20,000,000 (of which only approximately $5 million has been drawn down) when the parent company has $40,000,000 in free cash? ***"[C]redit should not be approved when it is sought for the primary benefit of a party other than the debtor or when funds are readily available from insiders*** or others without providing the lender with the benefits of any priority." *In re Aqua Associates*, 123 B.R. 192, 196 (Bankr. E.D. Pa. 1991) (emphasis added). The Debtors' parent has funds readily available to finance the Debtors' operations if, in fact, the Debtors need financing.

C. The Financing Arrangement Cannot Operate as a *Sub Rosa* Plan Of Reorganization Or Skew The Bankruptcy Process.

It is well established that financing arrangements pursuant to 11 U.S.C. § 364 cannot be used as a *sub rosa* plan of reorganization. *See, e.g., Resolution Trust Corp. v.*

Official Unsecured Creditors Comm. (In re Defender Drug Stores, Inc.), 145 B.R. 312, 317 (B.A.P. 9th Cir. 1992) ("The bankruptcy court cannot, under the guise of section 364, approve financing arrangements that amount to a plan of reorganization but evade confirmation requirements."); *In re Chevy Devco,* 78 B.R. 585, 589 (Bankr. C.D. Cal. 1987) (finding that because "the proposal that was brought to this Court is equivalent to its plan of reorganization . . . the Court finds that it must use its equitable powers and employ a balancing test to look at detriment and benefit to the various parties."). The Honeywell Loan is not really a financing transaction but is a highly negotiated straight-jacketed blueprint for a reorganization of Honeywell's (and only incidentally of the Debtors') liabilities. It effectively locks the Debtors into a plan of reorganization approved by Honeywell.

Because the DIP Credit Agreement gives Honeywell complete control over the plan of reorganization, it operates as a *sub rosa* plan of reorganization. *See* DIP Credit Agreement at 28, Article 4.01(a)(i) ("All 'first day orders' and other orders entered by the Bankruptcy Court . . . shall be in form and substance satisfactory to the Lender and its counsel"); 52, Article 8.21 (plan of reorganization must be "in form and substance acceptable to the Lender"); 55, Article 9.01(r) (any plan of reorganization is proposed (by anyone, including the Debtors) after the exclusivity period has ended must be satisfactory to the Honeywell Lender — in its sole discretion — or it is an event of default).

The Bankruptcy Code's DIP financing provision is designed to benefit the estate's creditors. Section 364 cannot be used to skew the conduct of the bankruptcy or leverage the bankruptcy process to the benefit of a party in interest rather than the bankruptcy estate. *In re Ames Depart. Stores, Inc.,* 115 B.R. 34, 38, 40 (Bankr. S.D.N.Y. 1990) (discussing cases in which courts refused to approving financing arrangements under section 364(d), citing one where "the arrangement would skew the conduct of the bankruptcy case, destroy the adversary process that contemplates representation by counsel and deprive the estate of possible rights and powers" and noting that the cases "consistently reflect that the court's discretion under section 364 is to be utilized on grounds that permit reasonable business judgment to be exercised as long as the financing agreement does not contain terms that leverage the bankruptcy process and powers or its purpose is not so much to benefit the estate as it is to benefit a party-in-interest.").

The DIP Credit Agreement leverages the bankruptcy process to the benefit of the Honeywell Lender and not the bankruptcy estate. *See* DIP Credit Agreement at 55, Article 9.01(n) (it is an event of default if the Debtors in the exercise of their fiduciary duties are successful in opposing any injunction against the prosecution of any asbestos related claims against Honeywell); 56, Article 9.02 (the Honeywell Lender may realize on the DIP Collateral (all property and property interests now owned or hereafter acquired by Debtors) with only five business days' notice to the United States Trustee and any statutory committee of unsecured creditors); and 14 (defining Matured Specified Event of Default and providing a ninety day cure period for only three specified events of default and presumably no cure period whatsoever for any other event of default). For these foregoing reasons, the DIP Credit Agreement should not be approved.

D. **The Financing Arrangement Is Not Proposed In Good Faith; It Allows The Honeywell Lender To Become The "Puppeteer Of A Marionette-Debtor."**

It is obvious from the DIP Credit Agreement that the transaction has an intended effect that is improper under the Bankruptcy Code. It allows the Honeywell Lender to "seize control of the reins of reorganization" and to "have the ultimate say over the very goal of this Chapter 11 case, a confirmed plan of reorganization." *Tenney Village*, 104 B.R. at 568. The DIP Credit Agreement improperly "pervert[s] the reorganization process from one designed to accommodate all classes of creditors and equity interests to one specially crafted to the benefit" of the Honeywell Lender. *Id.* "An extension of credit having such an ulterior purpose is not in good faith within the meaning of section 364(e)." *EDC Holding Co.*, 676 F.2d at 949. The DIP Credit Agreement here enables the Honeywell Lender to become the "puppeteer of a marionette-debtor." *See Norris Square Civic Ass'n v. St. Mary Hosp. (In re St. Mary Hosp.)*, 86 B.R. 393, 401-02 (Bankr. E.D. Pa. 1988) (finding that the parent-lender had manufactured the financial crisis requiring the loan, refusing "to find the terms 'fair, reasonable, and adequate' under the circumstances." and noting that the proposed lender "is not an outside lender but the puppeteer of a marionette-debtor.").

In these situations courts disallow the improper financing arrangement. In a case in which the financing agreement improperly allowed for payments to a creditor's attorney for proving his client's case, the court found a lack of good faith:

> [Forcing the company's general creditors to pay the union's legal expenses] is an improper use of the bankrupt's estate to which the general creditors are the residual claimants. ***The fact that [the lender] was a defendant in the suit by the union actually strengthens the inference of bad faith. [The lender] was not a disinterested lender but a settling litigant that saw an opportunity to reduce the cost of the settlement by putting the union's lawyers ahead of the general creditors or [the debtor]. An extension of credit having such an ulterior purpose is not in good faith within the meaning of section 364(e).***

EDC Holding Co., 767 F.2d at 949 (emphasis added). Because the intended effect of the DIP Credit Agreement is *improper* under the Bankruptcy Code, it is not proposed in good faith.[1]

IV.

CONCLUSION

The Debtors have not met the requirements to obtain credit under 11 U.S.C. § 364(d). The financing agreement has not been proposed in good faith because it improperly perverts the reorganization process and provides the Honeywell Lender with an unfair advantage vis á vis the Tort Victims and other creditors. When the proposed transaction is viewed with the requisite heightened scrutiny, it is apparent that the DIP Financing Motion should be denied.

For all of the foregoing reasons, the DIP Financing Motion should be denied and the proposed Honeywell Loan should not be approved.

[1] Extension of credit under 11 U.S.C. § 364 is not affected by a reversal on appeal if the entity extending the credit acted in good faith. 11 U.S.C. § 364(e) *New York Life Ins. Co. v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 901 F.2d 1359, 1366 (6th Cir. 1990) (stating "[e]xtension of credit 'in good faith' is a requisite spelled out specifically in § 364(e)" and remanding to the bankruptcy court for an explicit finding on the issue of good faith); *In re EDC Holding Co., Inc.*, 676 F.2d 945, 948 (7th Cir. 1982) ("Where it is evident from the loan agreement itself that the transaction has an intended effect that is improper under the Bankruptcy Code, the lender is not in good faith, and it is irrelevant what the improper purpose is.").

Dated: February 6, 2002

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CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the above and foregoing was served by facsimile on the parties on the attached service list on this the 6th day of February, 2002.

/s/
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For Balance

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Documents