IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
ARMSTRONG WORLD INDUSTRIES, INC., *et al.*,	)	Case No. 00-4471 (JKF)
	)	
	)	Jointly Administered
Debtors.	)	
		Re: Docket No. 9422

THE OFFICIAL COMMITTEE OF ASBESTOS CLAIMANTS' AND THE LEGAL REPRESENTATIVE FOR FUTURE ASBESTOS CLAIMANTS' AMENDED[1] JOINT PRE-HEARING BRIEF IN SUPPORT OF PLAN CONFIRMATION

[1] On May 17, 2006 the Armstrong Official Committee of Asbestos Claimants (the "ACC") and Dean M. Trafelet, the legal representative for the Debtor's future asbestos personal injury claimants (the "Futures Representative" and together with the ACC, the "Plan Supporters") filed *The Official Committee of Asbestos Claimants' and the Legal Representative for Future Asbestos Claimants' Joint Pre-Hearing Brief in Support of Plan Confirmation* (Docket No. 9422). It was later discovered that a typographical error appeared on page 16. In order to correct this error the Plan Supporters are filing *The Official Committee of Asbestos Claimants' and the Legal Representative for Future Asbestos Claimants' Amended Joint Pre-Hearing Brief in Support of Plan Confirmation.*

TABLE OF CONTENTS

TABLE OF AUTHORITIES

FEDERAL CASES

STATE CASES

FEDERAL STATUTES

MISCELLANEOUS

The Armstrong Official Committee of Asbestos Claimants (the "ACC") and Dean M. Trafelet, the legal representative for the Debtor's future asbestos personal injury claimants (the "Futures Representative," and together with the ACC, the "Plan Supporters") hereby submit this joint pre-hearing brief setting forth the basic legal principles and factual background relevant to the forthcoming hearing and the evidence to be offered by the Plan Supporters in support of Plan Confirmation.

PROCEDURAL BACKGROUND

This hearing is part of the proceedings on confirmation of the Fourth Amended Plan of Reorganization of Armstrong World Industries, Inc., as Modified (the "Plan") proposed by the Debtor and supported by the ACC and the Futures Representative.

Armstrong filed its Fourth Amended Plan of Reorganization of Armstrong World Industries, Inc. (the "2003 Plan") and the Disclosure Statement to the Fourth Amended Plan (the "Disclosure Statement") with the Bankruptcy Court in May 2003. Although the Official Committee of Unsecured Creditors (the "UCC") approved the 2003 Plan, its constituency voted against the plan because of then-current activity in the United States Senate Committee on the Judiciary on the subject of federal asbestos legislation. Based on that vote, the UCC then reversed field and objected to confirmation of the 2003 Plan, in part on the ground that a greater potential distribution to commercial creditors would result if federal asbestos legislation (the so-called "FAIR Act") were passed. At the time, the UCC's expert, Dr. Letitia Chambers, testified that she thought it was more than likely that the FAIR Act would be enacted in the spring of 2004. Notwithstanding that testimony, the FAIR Act has not passed and no such opinion or ground of objection is being offered in this hearing in 2006.

The Bankruptcy Court recommended confirmation of the 2003 Plan, but this Court issued a memorandum and order on February 23, 2005, denying confirmation of that plan based on the

provisions for issuance of warrants to shareholders of Armstrong, which is unrelated to what is at issue in this proceeding. *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D. Del. 2005). That decision was affirmed by the Third Circuit. *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005).

The Plan is virtually identical to the 2003 Plan, except for the elimination of the distribution of warrants to shareholders that this Court and the Court of Appeals held was improper. The UCC has now objected to the Plan on the grounds that it allegedly discriminates unfairly against the unsecured commercial creditors.

OVERVIEW OF THE ISSUES

The UCC's objection to the Plan is that it allegedly allocates too much of the Debtor's assets to a trust (the "Trust") to be created, pursuant to section 524(g) of the Bankruptcy Code, for payment of present and future claims for personal injuries and deaths caused by exposure to asbestos-containing products for which Armstrong is responsible,[2] and therefore discriminates unfairly against the commercial creditors. The parties agree that if Armstrong's aggregate asbestos personal injury liability is at least $3.1 billion present value, then the Plan does not discriminate unfairly against the unsecured commercial creditors and the Plan may be confirmed.[3]

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[2] All parties agree that any viable plan of reorganization for Armstrong will need to take advantage of 11 U.S.C. § 524(g), the special statutory provision that allows a plan of reorganization to include an injunction channeling not only present asbestos personal injury claims, but also future "demands," to a trust created under the Plan to receive, evaluate, and, where justified, pay such claims. Such pending and future claims against Armstrong, which include future "demands" as defined in section 524(g), are hereinafter referred to as "Asbestos Personal Injury Claims."

[3] There does not appear to be any basis for dispute that $3.1 billion present value is the threshold amount for finding that the Plan does not discriminate unfairly against the unsecured commercial creditors. Under the Plan, the unsecured creditors (Class 6) would receive assets valued at approximately $982 million, which is 59.5% of their $1.651 billion in

(continued...)

Based upon the reports and testimony of their respective experienced and well-recognized experts, the Futures Representative and the ACC believe that the reasonable estimate of the Asbestos Personal Injury Claims is in the range of $4.0 billion to $6.038 billion present value.[4] However, the terms of the Plan are such that if a reasonable estimate is at least $3.1 billion present value, the treatment of all unsecured creditors will be fair.

The parties have agreed that, since the stream of liability obligations would extend over many years, it is necessary to reduce the nominal value of the asbestos claims which will accrue over time to a present value so that it can be compared with the present value of the claims of the other creditors. They have further agreed on the use of a risk-free discount rate of 5.55% to arrive at present value. Hereinafter all references to the "value" or "amount" of the estimated Asbestos Personal Injury Claims is to their present value, so determined.

LEGAL STANDARDS

Measure of "Unfair Discrimination"

As will be demonstrated at the hearing, the UCC's objection should be rejected. Where, as here, an impaired class of claims has not consented to a proposed plan of

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claims. The Plan provides that Armstrong would place approximately $1.8 billion of its assets into the Trust for the present and future asbestos claimants (Class 7) pursuant to 11 U.S.C. § 524(g). Accordingly, since $1.8 billion is approximately 59.5% of $3.1 billion, if the estimated aggregate Asbestos Personal Injury Claims are $3.1 billion or more, the 59.5% recovery of the unsecured commercial creditors on their claims will be equal or greater than the percentage recovery of the present and future asbestos claimants. To the degree the estimated amount of Armstrong's Asbestos Personal Injury Claims is greater than $3.1 billion, the unsecured commercial creditors are benefited because their share of Armstrong's assets under the Plan will be greater than if their share of the assets was based on the actual estimated amount of the Asbestos Personal Injury Claims.

[4] Dr. Mark Peterson, the ACC's expert, concludes that the present value is $6.038 billion. The Futures Representative's expert, Dr. B. Thomas Florence, estimates a range of liability of $4.0 to $4.9 billion present value. The median of his projections is $4.5 billion. For simplicity, future references to Dr. Florence's estimate use the $4.5 billion median figure.

reorganization, section 1129(b)(1) of the Bankruptcy Code permits confirmation, "if the plan does not discriminate unfairly . . . with respect to each class of claims [that] . . . has not accepted the plan." 11 U.S.C. § 1129(b)(1).[5] Unfair discrimination does not exist where the plan "ensures that a dissenting class will receive relative value equal to the value given to all other similarly situated classes." *In re Johns-Manville*, 68 B.R. 618, 636 (Bankr. S.D.N.Y. 1986); *see In re Resorts Int'l, Inc.*, 145 B.R. 412, 481 (Bankr. D. N.J. 1990) (no unfair discrimination where plan provides equal treatment for like classes); *see also* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. at 416 (1977) (noting that where an impaired, objecting class receives less than full value under the plan, unfair discrimination does not exist "if the [objecting] class is not unfairly discriminated against with respect to equal classes and if junior classes will receive nothing under the plan").[6] Here there is no unfair discrimination because, as the evidence will show, the Plan

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[5] In bankruptcy terms, confirmation of a plan despite the rejection by one or more classes is referred to as a "cramdown."

[6] Even if a plan discriminates, it may still be confirmed if there is a reasonable basis for the discrimination so that the discrimination is not "unfair." *See In re Lernout & Hauspie Speech Prods., N.V.*, 301 B.R. 651, 660 (Bankr. D. Del. 2003) (citing *In re Ambanc La Mesa L.P.*, 115 F.3d 650, 656 (9th Cir. 1997); *In re Dow Corning Corp.*, 244 B.R. 696, 700 (Bankr. E.D. Mich. 1999); *In re Jim Beck, Inc.*, 214 B.R. 305, 307 (W.D. Va. 1997), *aff'd*, 162 F.3d 1155 (4th Cir.1998)). A dissenting creditor class alleging unfair discrimination must sustain the burden of coming forward with *some* evidence to establish the unfairness of such discrimination. *In re Lernout & Hauspie Speech Prods.*, 301 B.R. at 656. To establish a presumption of unfair discrimination that the proponents of the plan must rebut, an objecting party must show not just a dissenting class and another class of the same priority, but "a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class . . . or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution." *In re Dow Corning Corp.*, 244 B.R. at 702 (citation omitted); *see also In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213, 228-29 (Bankr. D. N.J. 2000). Here, instead of the commercial creditors receiving a materially lower percentage recovery than the asbestos claimants, there is every reason to expect they will receive a greater percentage on any reasonable estimate of the amount of Armstrong's Asbestos Personal Injury Claims.

provides the unsecured commercial creditors with an equal or better return on their claims than that provided through the Trust to pending and future asbestos personal injury claimants.

In most chapter 11 cases, a determination of the appropriateness of the proposed allocation of assets among creditor classes is simplified by the fact that all or most creditors' claims are liquidated in amount and those in dispute can be resolved, if necessary, by trial. Here, however, the single largest creditor group is composed of people whose eligibility for compensation stems from claims for personal injury and wrongful death resulting from exposure to asbestos-containing products for which Armstrong is responsible. All parties agree that liquidating each of these claims is impossible. Only a small fraction of even the *pending* asbestos personal injury claims against Armstrong are liquidated in amount as a result of pre-petition settlements or judgments. Over 140,000 pending claims remain unliquidated and liquidating them on an individual basis would take years, if indeed it were possible at all.[7] Moreover, future asbestos claims, consisting of claims for injuries caused by past exposure, which have yet to manifest themselves in diagnosable injuries or illnesses and which all experts agree will far exceed the number of pending claims, obviously cannot be liquidated now.

In this circumstance, because an allocation of assets under the Plan has already been proposed, this Court is not required, as courts have been in certain other asbestos bankruptcy

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[7] *See* Mark A. Peterson, *Armstrong World Industries, Inc. Projected Liabilities for Asbestos Personal Injury Claims As of December 2000*, expert for the ACC, dated March 29, 2006 at 7 (141,175 unliquidated pending claims) ("Peterson Report"); B. Thomas Florence, *Estimate of the Number and Value of Pending and Future Claims for Asbestos-Related Personal Injury Claims Filed and Which Will Be Filed Against Armstrong World Industries, Inc.*, expert for the Futures Representative, dated March 29, 2006 at 18 (141,526 pending claims) ("Florence Report"); Letitia Chambers, *Expert Witness Report of Dr. Letitia Chambers*, expert for the UCC, dated March 29, 2006 at 15 (147,683 pending claims) ("Chambers Report").

proceedings, to make a definitive aggregate liability estimate for the Asbestos Personal Injury Claims.[8] Instead, the Court need only determine whether a reasonable estimate of the present value of Armstrong's aggregate asbestos-related personal injury liability is at least $3.1 billion, so that the unsecured commercial creditors receive at least as favorable treatment as the Trust for the asbestos claimants. Where there is no difference in treatment, there is no discrimination, unfair or otherwise.

The preponderance of the evidence, and not some more exacting standard, is the standard of proof for establishing that a reasonable estimate of Armstrong's Asbestos Personal Injury Claims is at least $3.1 billion and therefore the Plan does not discriminate unfairly – or indeed at all – against the unsecured commercial creditors. *In re Briscoe Enters.*, 994 F.2d 1160, 1165 (5th Cir. 1993); *see also In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 616 n.23 (Bankr. D. Del. 2001) ("[P]roponent must show that a plan is fair and equitable by a preponderance of the evidence.").

The proof will show that the Asbestos Personal Injury Claims total $3.1 billion or more, so that the other unsecured creditors will suffer no unfair discrimination under the Plan, and, indeed, no discrimination at all. Significantly, even the UCC's estimation witness, Dr. Letitia Chambers, conceded that "I don't consider the 3.1 to be . . . totally out of the ballpark" and considered it only "at or above the high end of what I think would be a reasonable estimate." Chambers Dep. Tr. at 238.

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[8] *See, e.g., Owens Corning v. Credit Suisse First Boston (In re Owens Corning),* 322 B.R. 719 (D. Del. 2005); *In re Federal-Mogul Global Inc.*, 330 B.R. 133 (D. Del. 2005); *In re Eagle-Picher Indus., Inc.*, 189 B.R. 681 (Bankr. S.D. Ohio 1995).

Standards for Estimation

The legal standard governing estimation of asbestos personal injury claims has been set forth in a series of decisions, including *Owens Corning v. Credit Suisse First Boston,* 322 B.R. 719, 721-22 (D. Del. 2005), *appeal pending*; *In re Federal-Mogul Global Inc.*, 330 B.R. 133, 155 (D. Del. 2005), *appeal pending on other grounds*; *In re Armstrong World Indus., Inc.,* 2003 Bankr. LEXIS 2156 (Bankr. D. Del. Dec. 19, 2003), *rev'd on other grounds* 320 B.R. 523 (D. Del. 2005), *aff'd*, 432 F.3d 507 (3d Cir. 2005); *In re Babcock & Wilcox Co.*, No. 00-10992, (Bankr. E.D. La. Nov. 9, 2004) (Amended Findings of Fact and Conclusions of Law); *In re Eagle-Picher Indus. Inc.*, 189 B.R. 681, 683 (Bankr. S.D. Ohio 1995); and *In re National Gypsum*, No. 390-37213-SAF-11, slip op. at 12-17 (N.D. Tex. Jan. 29, 1993).

The case law establishes the basic legal principles that apply to the estimation of asbestos personal injury claims. First, the validity and amount of asbestos personal injury tort claims in bankruptcy are governed by state tort law. *Owens Corning,* 322 B.R. at 721-22; *Federal-Mogul*, 330 B.R. at 155. As the Supreme Court made clear in *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20 (2000), "[t]he 'basic federal rule' in bankruptcy is that state law governs the substance of claims, Congress having 'generally left the determination of property rights in the assets of a bankrupt's estate to state law.'" (quoting *Butner v. U.S.*, 440 U.S. 48, 54, 57 (1979)). *See also Grogan v. Garner*, 498 U.S. 279, 283-84 & n.9 (1991) (while the issue of non-dischargeability is a matter of federal law, the "validity of a creditor's claim is determined by rules of state law"). This basic bankruptcy law principle was applied in the seminal estimation case in this Circuit, *Bittner v. Borne Chem. Co.*, 691 F.2d 134 (3d Cir. 1982), where the Third Circuit declared that a court making an estimation must look to what the claim is worth under applicable state law:

> In determining the legal merits of a case on which claims . . . are based, *the bankruptcy court should be guided by the applicable state law*.

Id. at 138 (emphasis added). Other courts have similarly held that state substantive tort law determines the amount and value of claims in an estimation. *See In re Farley, Inc.*, 146 B.R. 748, 753 (Bankr. N.D. Ill. 1992).

Second, the estimate is determined based on what the company's liability would have been to pending and future claimants if the company had continued in the tort system, rather than entered into bankruptcy. *Owens-Corning,* 322 B.R. at 722; *Federal-Mogul*, 330 B.R. at 158, 162; *Eagle-Picher*, 189 B.R. at 691-92. Thus, the estimation of the Asbestos Personal Injury Claims must be based on how asbestos personal injury claims against Armstrong would be handled if it continued in the actual tort system, not on how claims might be handled in some hypothetical alternative system.

Third, the claims are to be valued as of the bankruptcy petition date. *Owens Corning,* 322 B.R. at 722; *Federal-Mogul,* 330 B.R. at 157.

Finally, in estimating pending and future asbestos claims, it is appropriate to utilize the debtor's historical experience in the tort system. *Federal-Mogul*, 330 B.R. at 157; *Eagle-Picher*, 189 B.R. at 690 ("The estimate should be primarily based upon the history of *this* company.") (emphasis in original). Reference to actual experience in the tort system is a standard feature in estimation. *See, e.g., In re Fed. Press Co.,* 116 B.R. 650, 654 (Bankr. N.D. Ind. 1989) (estimated personal injury claims as equal in value to the nationwide average of unreduced jury verdicts for similar injuries); *Farley*, 146 B.R. at 752, 756 (estimated personal injury claim by multiplying the likely verdict by the chance of success). Similarly, in asbestos bankruptcies like Armstrong's, reliance on a debtor's past experience is the method that virtually all bankruptcy courts have used. *See, e.g., Federal-Mogul*, 330 B.R. at 157; *Eagle-Picher*, 189 B.R. at 690;

Johns-Manville, 68 B.R. at 635 (Estimation was "based upon known present claimants and reasonable extrapolations from past experience and epidemiological data.").

Although the historical experience of a debtor is critical for estimating asbestos personal injury liability, courts have also recognized that it is appropriate to take into account foreseeable trends in the settlement data and the litigation landscape that the debtor would face absent bankruptcy. *Owens Corning,* 322 B.R. at 721; *Federal-Mogul,* 330 B.R. at 161-62. How such foreseeable trends impact the estimate depends on the facts of the particular case and the ability of the experts to reasonably quantify them. *See Owens Corning,* 322 B.R. at 721-22; *Federal-Mogul,* 330 B.R. at 161 (holding that the record before the court "does not supply the factual support necessary to intelligently quantify" the effect of certain factors which had allegedly inflated prior claim values). In considering the impact of changing factors and trends, courts should also consider whether they are already reflected in the existing settlement history of the debtor. *See Federal-Mogul,* 330 B.R. at 162.

FACTUAL BACKGROUND

Armstrong's Asbestos Culpability

As of the Petition Date, between 480,000 and 520,000 asbestos personal injury claims had been filed against Armstrong, of which approximately 141,000 were still pending. Historically, approximately 3-4% of total claims were for mesothelioma, 6% were for lung cancer claims, 2% were other cancer claims, and 88-89% were non-cancer claims. *See* Peterson Report at 28; Florence Report at 8-9.

It is not surprising that a great many claims would be filed against Armstrong. Armstrong-branded products containing asbestos, both those manufactured by it and those it licensed or otherwise permitted to carry its logo or other markings, were widely distributed

throughout the United States and Canada.[9] From the early part of the 20th century until at least the mid 1970s, Armstrong, along with its subsidiaries Armstrong Contracting and Supply (later known as ACandS) ("Armstrong Contracting") and National Cork Company, and other entities it licensed or permitted to use its marks, operated one of the nation's leading insulation contracting businesses, selling and installing asbestos-containing products manufactured by Armstrong, products of other manufacturers branded with Armstrong's marks, and products manufactured by others and installed by Armstrong or Armstrong Contracting without any logo. In addition, Armstrong and its subsidiaries engaged in the manufacture and distribution of other asbestos-containing products from the early 1900s until the 1980's, including asbestos-containing flooring materials, roofing materials and gaskets. (*See* Disclosure Statement at 16; RFA's ¶¶ 101, 102, 105, 106, 110, 112).

Over 90% of the asbestos-related personal injury claims brought against Armstrong have been based upon exposure to insulation products it sold and/or installed. (RFA's ¶ 122). Because Armstrong's insulation contracting activities were nationwide and its trademarks were easily identifiable and memorable, product identification defenses were largely unsuccessful in defending against asbestos personal injury claims.

As a result of these manufacturing and contracting operations, millions of workers in a variety of industries and occupations were exposed to asbestos from products for which Armstrong is responsible. Beginning in the early 1970's, Armstrong was named as a defendant in a significant number of asbestos personal injury lawsuits, including the landmark 1973 case, *Borel v. Fibreboard Paper Prods. Corp.*, 493 F.2d 1076 (5th Cir. 1973), which established the

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[9] Armstrong and its subsidiaries sold and/or installed at least 39 different types of asbestos-containing products. *See* Disclosure Statement at 15-16; Armstrong's Responses to the UCC's First Request for Admissions, ("RFA's") ¶ 98.

doctrine that asbestos manufacturers could be held liable for failing to warn workers of asbestos hazards of which the manufacturers either were, or should have been, aware.

Armstrong's Liability for Installation and Contracting Exposures

Armstrong's insulation installation business was conducted directly until 1958, and then from 1958 to August 1969 through Armstrong's wholly-owned subsidiaries. (Armstrong's Disclosure Statement at 14). After Armstrong Contracting was sold in August 1969, Armstrong continued to license or otherwise permit it and other entities to use certain Armstrong trademarks and other distinctive identifying brands and marks on asbestos-containing products. (Disclosure Statement at 14; RFA's ¶ 51).

In defending itself in the tort system, Armstrong attempted to argue that it was not liable for the post-1957 activities of Armstrong Contracting. (RFA's at 73). This defense was unsuccessful as a matter of law, because the various theories on which Armstrong could be held liable, including alter ego, trademark liability and relabeling liability, presented factual issues. (Keating[10] Dep. Tr. at 42-45, 77-79, 131-32). To support claims of Armstrong's post-1957 liability, plaintiffs relied upon evidence of the close interrelationship that existed between the two companies while Armstrong Contracting was a wholly-owned Armstrong subsidiary, seeking to convince the jury that Armstrong was in fact dealing with Armstrong Contracting in a way that should cause Armstrong to be found liable for those products. In addition, plaintiffs pointed to trademark licensing agreements authorizing Armstrong Contracting to utilize Armstrong's trademarks and to re-labeling agreements with asbestos manufacturers who supplied Armstrong Contracting, such as Owens Corning and Eagle-Picher, pursuant to which

[10] Lawrence Keating was Armstrong's in-house counsel with principal responsibility for asbestos personal injury litigation from 1978 through 1998. His testimony will be presented by deposition.

Armstrong's logo continued to appear on asbestos-containing insulation products installed by Armstrong Contracting after 1957.

Armstrong's former in-house and outside defense counsel have repeatedly emphasized that post-1957 liability was a jury issue, rather than one that could be conclusively resolved through summary judgment motions. (Keating Dep. Tr. 43:20-44:7; 49:22-24; 78-79; 145:2-8). Indeed, Armstrong's counsel decided to avoid pursuing legal rulings on the issue of its liability for Armstrong Contracting because of the risk of an adverse result that could then be used against Armstrong in future litigation. (Keating Dep. Tr.44:13-18; 136:7-24). Moreover, Armstrong became concerned that aggressively pursuing the post-1957 liability issue would make it a heightened target of plaintiffs' attorneys. (Keating Dep. Tr.82:13-23).

Presumably recognizing this reality, the UCC's estimation witness, Dr. Chambers, has assumed that Armstrong's liability for asbestos-related contracting activities and insulation products extends through 1969.[11] However, even for the period after Armstrong Contracting was sold, Armstrong still is at risk of being held liable for the installation activities of Armstrong Contracting because Armstrong continued to license or otherwise permit Armstrong Contracting and other entities to use certain of its trademarks and other distinctive identifying brands and marks on asbestos-containing products. (Disclosure Statement at 14; RFA's ¶ 51). Under recognized tort law, this pattern of conduct makes Armstrong potentially liable for post-1969 asbestos exposure to asbestos-containing products installed by Armstrong Contracting. *See Brandimarti v. Caterpillar Tractor Co.*, 527 A.2d 134, 139-40 (Pa. Super. 1987) (holding that a defendant that allowed its name to appear on the allegedly defective product could be held strictly liable notwithstanding the fact that it did not manufacture the product at issue and was

[11] Chambers Report at 28.

not a supplier of the product "participating in the chain of distribution"); *Connelly v. Uniroyal, Inc.*, 389 N.E.2d 155, 163 (Ill. 1979) (ruling that a trademark licensor could be held liable for injuries caused by allegedly defective tire even though the defendant "may not have been a link in the chain of distribution").[12]

Armstrong's Defense Strategies

Throughout its history in the tort system, Armstrong asserted various product identification and medical defenses and took other actions in an attempt to minimize its liability. (Keating Dep. Tr. at 32:15-21; 42-45; 110; 17-22; 142:7-12; 154:15-155:3; *see also* RFA's ¶ 73). Initially, Armstrong defended asbestos claims brought against it as a stand-alone defendant. In the late 1970's and early 1980's, Armstrong worked with its insurance carriers to settle large groups of cases at relatively modest settlement values (with some notable exceptions where values paid were very high). However, claims against Armstrong steadily increased, as did Armstrong's liability. In 1985, Armstrong chose to deal with its asbestos liabilities in cooperation with other defendants and their insurers as part of the Asbestos Claims Facility ("ACF"), the first major effort of a group of asbestos defendants to mount a coordinated defense against asbestos personal injury claims. Armstrong believed that this strategy would be most effective in minimizing its liability and defense costs and maximizing insurance coverage.

ACF's strategy was to settle claims on a group basis, which tended to reduce the defendants' liability because ACF was able to negotiate significantly lower per-case settlement values. Armstrong's share in ACF settlements was based on its pre-ACF history in the tort

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[12] Confirming this risk, prior to bankruptcy Armstrong had been denied summary judgment on the issue of whether it was liable for activities of Armstrong Contracting even though the plaintiff's asbestos exposure was alleged to have occurred between 1968 and 1972. *Dyson v. ACandS, Inc.*, No. C0048AB200000009 (Pa. Ct. Com. Pl. Dec. 6, 2000).

system as agreed with the other members. Armstrong continued to defend claims as part of ACF until the ACF disbanded in 1988.

As the ACF was disbanding, Armstrong together with a number of other ACF members formed the Center for Claims Resolution ("CCR"), a new consortium of asbestos defendants, in which Armstrong remained a member until the Petition Date. Like the ACF, the CCR provided joint defense and settlement negotiation services for its members. CCR members contributed to payment of judgments, settlements, and defense costs according to agreed (and periodically adjusted) formulas based on relative shares of responsibility for asbestos-related injuries for different industries and job sites. For most of CCR's existence, only CCR members named in a lawsuit contributed to payments related to that lawsuit. (*See* 6/1/05 Hanlon Dep. Tr. at 32-33).[13] Before settling and paying a claim, the CCR required evidence of both an asbestos related disease that would be compensable under state tort law and proof that the plaintiff was exposed to an asbestos-containing product of at least one of the CCR members who were named in the complaint. (*See* Federal Mogul Hearing Tr. at 68-69).

Armstrong's decision to join the CCR and to remain a member was based upon the company's reasoned belief that its liability for asbestos personal injury claims would have risen considerably had it chosen to leave the CCR and defend itself as a stand-alone defendant in the tort system. Throughout the period that Armstrong was a member of the CCR, it frequently evaluated how non-CCR asbestos defendants faired in handling their asbestos litigation claims and examined relevant trends in asbestos litigation. (Keating Dep. Tr. at 121). Armstrong decided to remain in the CCR because it determined that both its liability and its defense costs

[13] William Hanlon is Special Counsel to the CCR. His testimony will be offered by deposition.

were, and would continue to be, lower as a result of its membership in the CCR, so that continued participation served Armstrong's economic interest. (Keating Dep. Tr. at 121-24).

Armstrong also successfully negotiated to lower its share of liability as a member of the CCR. (Keating Dep. Tr. at 110-111). Under CCR policies, all CCR members named in a given lawsuit would contribute to the payment of settlement or verdict costs, so long as one such member was found liable. However, as Daniel Myer will testify, the CCR took product identification against all CCR defendants named in a complaint into account in negotiating settlements, reducing the plaintiff's aggregate recovery against the named CCR defendants, or in some instances even obtaining outright dismissals, where exposure evidence against some CCR defendants was weak or non-existent.[14]

While in the tort system, Armstrong had few punitive damage verdicts and had no significant punitive damage awards entered against it. Edward Houff, who served as Armstrong's punitive damages counsel beginning in 1985, will testify that the potential for a punitive damage award did not influence the amount Armstrong was willing to pay in settling cases and that it was well known that Armstrong was not willing to pay more because of a threat of punitive damages. He will also testify that both ACF and CCR had policies of not paying more for settlement because of a risk of punitive damages.

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[14] Armstrong's determination that it would fare better as a member of CCR as opposed to a stand alone defendant was proven correct by the experience of Turner and Newall, Ltd., an asbestos defendant who chose to leave the CCR in January 2001. Paul Hanly, T&N's former primary coordinating outside counsel, will testify by deposition that, between the time when T&N left the CCR until it filed for bankruptcy in October 2001, T&N's costs to resolve mesothelioma claims skyrocketed by over 75% and the total number of claim filings against T&N increased substantially. In addition, the settlement values obtained by T&N for non-cancer cases during the period after T&N left the CCR were not sustainable and would only go up as the cases received trial dates. Accordingly, Mr. Hanly concluded by the end of 2001 that T&N's asbestos liability as a stand alone defendant had become far higher than its liability had been as a member of CCR.

Notwithstanding Armstrong's efforts to minimize its exposure to liability for asbestos claims as a member of CCR, in the final three years prior to its bankruptcy, Armstrong paid some half a billion dollars to asbestos personal injury claimants, virtually all of it through the CCR, as shown in Armstrong's and CCR's records. And, as all three estimation witnesses agree, between the years 1990 and 2000, Armstrong experienced significant increases in claim filings, and over the years just before bankruptcy, the amounts it had to pay to settle claims increased substantially, as shown in the following tables.[15]

Claims Filed

Year Received	Injury			
	Mesothelioma	**Lung**	**Other Cancers**	**Non-Malignant**
1990	843	1,744	515	22,416
1991	873	1,716	457	21,567
1992	962	1,846	571	25,901
1993	692	1,742	550	26,084
1994	974	1,412	483	16,274
1995	692	1,206	370	16,072
1996	755	1,667	673	32,369
1997	1,302	2,489	739	39,391
1998	1,752	3,468	1,122	63,619
1999	1,518	2,582	663	46,312
2000	1,748	2,502	789	52,931

Source: Florence Report at 7.

[15] The figures shown are those in Dr. Florence's tables. Florence Report at 7 (claims filed), 19 (average settlement payments). Dr. Peterson's shows a similar pattern of increases. Peterson Report at 28 (claims filed), 7 (average settlement payments). Dr. Chambers shows substantially similar numbers as Armstrong's actual experience. Chambers Report at 11 (claims filed); Supplemental work papers produced on May 12, 2006 (average settlement payments).

Average Settlement Payment for Claims Receiving a Greater-than-Zero Payment[16]

Year Closed	Mesothelioma	Lung Cancer	Other Cancer	Non-Cancer
1997	$37,472	$11,554	$6,122	$3,549
1998	$43,332	$11,242	$4,924	$1,647
1999	$50,755	$10,851	$5,209	$2,741
2000	$87,279	$16,456	$6,846	$3,598

Source: Florence Report at 19.

By late 2000, the current and prospective burden of defending and paying asbestos personal injury claims was unsustainable and Armstrong filed for bankruptcy protection under Chapter 11 on December 6, 2000.[17]

EVIDENCE TO BE PRESENTED BY THE ACC AND FUTURES REPRESENTATIVE

At the confirmation hearing, the ACC and Futures Representative will present evidence showing that the aggregate amount that Armstrong would have had to pay over the coming decades, for both pending and future asbestos personal injury claims, if it had remained in the tort system, substantially exceeds $3.1 billion. Witnesses who were responsible for the defense

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[16] The average settlement amounts are the average amounts that Armstrong in the years indicated paid to resolve claims with the specified injury for which a payment was made, including both verdicts and settlements. Prior to bankruptcy, Armstrong paid approximately 90% of claims filed against it.

[17] The Disclosure Statement states, with respect to the reason for Armstrong's filing, that as a result of Owens Corning Fiberglass Corp.'s ("OC") bankruptcy filing on October 5, 2000, Armstrong's lenders reevaluated the credit risk associated with Armstrong, primarily due to Armstrong's personal injury liability, and it was unable to obtain a new credit facility with acceptable terms to replace its existing facility, which was due to expire. In addition, because OC had been a major defendant in asbestos litigation, Armstrong was concerned that plaintiffs would increase settlement demands on Armstrong. Armstrong was unable to issue commercial paper and instead was forced to draw upon its existing credit facility. On December 6, 2000, the date of Armstrong's bankruptcy petition, Armstrong had drawn upon all of its $450 million credit facility. Accordingly, "in response to the large number of Asbestos Personal Injury Claims then outstanding, the increase in settlement demands over recent years and the resulting liquidity issues, AWI filed for protection under chapter 11 of the Bankruptcy Code on December 6, 2000." (Disclosure Statement at 17).

of Armstrong, CCR, and Turner & Newall, Ltd. ("T&N"), another major asbestos defendant that was also a CCR member, will summarize their extensive experience in representing and defending asbestos personal injury cases in court and in settlement negotiations, outlining how the defense was managed, the problems Armstrong and other defendants faced, the steps they took to minimize their liabilities, and how the CCR operated during the time Armstrong was a member. A medical expert will describe the medical bases for the claims considered compensable and the state of medical knowledge concerning the projected future incidence and prevalence of asbestos-related diseases. Two recognized experts on estimation of asbestos liabilities, using established methodologies and taking into account medical science and historical patterns, but also considering likely future changes in the tort system, will explain how they reached estimates of Armstrong's Asbestos Personal Injury Claims of $4.0 – 4.9 billion and $6.036 billion present value, respectively.

Fact Witnesses

The Plan Supporters intend to offer the testimony of five fact witnesses in their case-in-chief. Mindful of the Court's admonition to reduce the amount of trial time, only two of the five fact witnesses will testify live, while the testimony of the other three fact witnesses will be offered by deposition in the form of designations and counter-designations rather than being read aloud during the hearing.

1. Edward Houff. Mr. Houff was one of Armstrong's principal outside defense counsel from 1981 through December 2000. He will testify about the defenses Armstrong raised to asbestos personal injury claims; the methods by which plaintiffs established exposure to asbestos-containing products manufactured, sold, used or installed by Armstrong or Armstrong Contracting; the evidence plaintiffs used to prove Armstrong's potential liability for asbestos insulation contracting activities; Armstrong's defense of such claims; medical evidence in

asbestos litigation; Armstrong's presentations at trial; and factors raised in negotiating settlements of asbestos personal injury claims. The Plan Supporters estimate that his direct examination will last 90 minutes.

2. Daniel Myer. Mr. Myer is a former claims settlement negotiator for the CCR who has continued to settle cases on behalf of asbestos defendants up to the present time. Mr. Myer will testify concerning the evidence required by the CCR before settling asbestos claims; the rising values of mesothelioma and other types of asbestos claims, both during the 1990-2000 time period and continuing to the present; and the impact of the demise of CCR on the average asbestos claims resolution costs of former CCR members United States Gypsum and Union Carbide. His testimony will show that defendants like Armstrong faced very real risks of large judgments if cases went to trial and how the CCR attempted to, and did, minimize the liability of its members by offering settlements in cases it judged could eventually get to a jury, while resisting claims it regarded as without merit. The Plan Supporters estimate that his direct examination will last 60-90 minutes.

3. Lawrence Keating (by deposition). Mr. Keating was Armstrong's in-house counsel with principal responsibility for asbestos personal injury litigation from 1978 through 1998. Mr. Keating will testify about the benefits Armstrong gained from the CCR and the bases for Armstrong's conclusion that joining and remaining in the CCR was the best way for Armstrong to minimize its overall liability for asbestos personal injury claims. Mr. Keating will also testify concerning Armstrong's settlement of claims involving exposure to asbestos-containing insulation sold or installed by its contracting division or, later, by ACandS.

4. William Hanlon (by deposition). Mr. Hanlon is the Special Counsel to the CCR. He will testify about the information CCR defendants required from plaintiffs to settle asbestos claims, the information CCR obtained from its members concerning the historical bases for their

asbestos liabilities, the methodology CCR used for allocating and periodically adjusting the cost of settlement payments among CCR defendants named in a lawsuit, the benefits CCR provided to its members as a way to minimize their aggregate and individual asbestos liability, and Armstrong's record of indemnity payments as a CCR member.

5. Paul Hanly (by deposition). Mr. Hanly is the former national defense counsel for T&N, another major asbestos defendant. T&N, like Armstrong, was a member of CCR; however, unlike Armstrong, it withdrew from the organization and was a "stand-alone" defendant for a period before it filed for bankruptcy protection. Mr. Hanly will testify about the benefits the CCR provided to its members as a way to minimize indemnity payments, and the experience of T&N in the tort system after the CCR stopped settling cases jointly on behalf of its members after February 1, 2001, including in particular the ensuing dramatic rise in the cost to resolve mesothelioma claims.

Medical Expert Witness

Dr. Laura Welch is a physician with extensive clinical and research experience with asbestos-related diseases. She will testify to the standards for diagnosis and causation of asbestos-related diseases, the effects of those diseases; the actual and projected incidence of mesothelioma in the United States; and the incidence or prevalence of other asbestos-related diseases in the United States and available information concerning such incidence and prevalence; and the epidemiology of asbestos-related cancers other than mesothelioma. She will also testify to recognition by the medical profession that significant asbestos-related diseases can be present in patients even where standard lung function tests or x-rays appear to be normal. The Plan Supporters estimate that her direct examination will last 60 minutes.

Estimation Experts

Methodological Principles

The amount of Armstrong's Asbestos Personal Injury Claims to be estimated in this proceeding is the sum of two elements:

The value of claims pending on the Petition Date

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The value of future claims, that is, those that will be filed in the future as people who were exposed in the past to asbestos-containing products for which Armstrong is responsible become of aware of symptoms and illnesses.

With respect to pending claims, there is no significant difference regarding the number of claims and the nature of the injuries alleged in the claims; that information is largely known from available databases.[18] However, it is necessary to make a judgment about how many claims will be paid and the amounts to be paid. For that too, the database provides an important source of information because it shows how similar claims were being evaluated and paid through litigation and by personnel negotiating settlements on behalf of Armstrong in the period just before bankruptcy. On the basis of their analysis of this information, the Plan Supporters' experts determine how many of the pending claims will receive payment and how much will be paid for these claims.

The process for future claims is essentially similar except that it is necessary to estimate not only what claims will be treated as valid and what values will prevail in the future, but also

[18] Some pending claims do not specify the particular injury or disease alleged, so the experts must impute a disease category – mesothelioma, lung cancer, other cancer, or non-cancerous pleural disease – to these claims.

how many claims will be filed.[19] In determining how many claims will be filed in the future, an important source of information is epidemiological projections, where they exist, of the likely future incidence of asbestos-related diseases, and the "propensity to sue," that is, the relationship between overall incidence and the filing of claims against a particular defendant. Additional factors are trends in determination of what claims are compensable, including foreseeable changes in the applicable substantive and procedural legal standards for handling and evaluating claims and trends in the amounts that will be paid to claims judged compensable.

ACC and Futures Representative's Application of Estimation Principles

The Court will be presented with evidence of Armstrong's estimated total asbestos-related personal injury liability through the testimony of the ACC's expert, Dr. Mark Peterson, and the Futures Representative's expert, Dr. B. Thomas Florence. Dr. Peterson's and Dr. Florence's estimates of Armstrong's Asbestos Personal Injury Claims are based on recognized epidemiological models of future asbestos-related diseases and analytic methodologies that they have utilized, and courts have accepted, in numerous prior asbestos bankruptcy cases.[20] They will testify to the steps in their analyses leading to their conclusions that the estimated Asbestos Personal Injury Claims (both present and future) against Armstrong is for Dr. Florence between $4.0 billion and $4.9 billion, with the median of this range being approximately $4.5 billion and for Dr. Peterson is $6.038 billion, both well above the $3.1 billion threshold. They have taken into account both the actual historical experience of Armstrong in the tort system and reasonably foreseeable trends in how that system would handle asbestos personal injury claims in the future.

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[19] As noted above, the parties have agreed that the projected future stream of payments must be discounted to present value at 5.55%, so the discounting process is not at issue here.

[20] *See e.g., Federal-Mogul*, 330 B.R. at 158-59 (Peterson); *Babcock & Wilcox*, No. 00-10992 at 47-48 (Peterson and Florence); *Eagle-Picher*, 189 B.R. at 686, 691 (Peterson and Florence); *National Gypsum*, 257 B.R. at 198-99 (Peterson).

While they differ in details, they both project that changes in both the incidence and prevalence of asbestos-related diseases and in patterns of filing claims and resolving them in the tort system would be relatively gradual, without drastic departures from past experience. The Plan Supporters estimate that Dr. Peterson's direct examination will last 2 hours and Dr. Florence's direct examination will last 90 minutes.

Dr. Peterson's analysis leads him to predict the continuation of clear pre-2001 trends – confirmed by the experience of other defendants who remained in the tort system after that date. There will, he concludes, be increased values for mesothelioma and other cancer claims, which affects estimates of Armstrong's liabilities for both pending and future claims. And there will be an increasing "propensity to sue" Armstrong and other defendants for mesothelioma and cancer claims. At the same time, his analysis projects that, as a result of "reforms" and other changes in the tort system, Armstrong would be able to reject a higher percentage of all claims submitted than was the case for claims against it in the CCR – and that the rejection rate for claims for non-cancer diseases would be higher than for cancers. Dr. Peterson estimates that the present value of Armstrong's total liability for present and future asbestos liabilities as of December 31, 2000 is approximately $6.038 billion using the agreed upon discount rate of 5.55%.

Dr. Florence's forecast of the number of claims to be filed against Armstrong in the future, claims acceptance rates, and the amounts that Armstrong would pay to resolve claims are largely based on the historical patterns and ways in which Armstrong managed its asbestos personal injury litigation in the approximately 25 years preceding Armstrong's bankruptcy. Dr. Florence recognizes that there have been changes in the tort system in the past, which are reflected in Armstrong's historical database, and that there will be changes in the tort system going forward. His forecast is a conservative one in that it assumes that Armstrong's management will continue to seek ways, as they have done in the past, of resolving Armstrong's

asbestos personal injury liabilities in the most cost-efficient manner. At the same time, Dr. Florence conducted sensitivity analyses relating to changes in the asbestos litigation environment since the Petition Date, including recent tort reform in specific states, as well as increasing claims resolution values. The analyses relating to tort reform, which primarily affected non-malignant claims, resulted in a minimal reduction to the forecasted aggregate liability. The analyses relating to increasing claims resolution values demonstrated that Dr. Florence's forecast of aggregate liability would have been substantially greater had he forecast any increase in claims resolution values above inflation. Dr. Florence prepared thirty-two alternative future claim estimates using conventional epidemiological and statistical forecasting approaches based on various assumptions. Dr. Florence forecasts that the present value of Armstrong's total liability for present and future asbestos claims as of the Petition Date, using the agreed upon discount rate of 5.55%, is between $4.0 billion and $4.9 billion, with the median of this range being approximately $4.5 billion.

Evidence Anticipated from the UCC

The evidence to be presented by the Plan Supporters is solidly based on the real world – the history of Armstrong and other defendants in the tort system, the experience of skilled and determined representatives who defended Armstrong and other asbestos defendants, the decisions Armstrong's management and the CCR's attorneys made about how to manage – and minimize – costs and risks, recognized epidemiological models, and the fundamental medical realities of asbestos-related conditions.

The UCC estimation witness,[21] Dr. Letitia Chambers, will take a different approach, as her report and deposition make clear. She ostensibly agrees that a proper estimate of

[21] The UCC has identified no fact witnesses. Its medical expert, Dr. Hans Weill, is not expected to disagree substantially with the proposition that any future decline in the incidence of (continued...)

Armstrong's Asbestos Personal Injury Claims must assume that the value and validity of the forecasted claims against Armstrong are decided presuming that Armstrong "would have been in the state law tort system," and not in bankruptcy. (Chambers Dep. Tr. at 8). However, Dr. Chambers made it clear at deposition that her estimate "does not model the day-to-day machinations of the legal profession," and that her estimate does not deal with "the particular legal machinations that went on in the CCR, compared to what might go on outside the CCR." (Chambers Dep. Tr. at 201:5-6; 205:7-9). In other words, Dr. Chambers' estimate does not model the current American tort system, but rather her own design of a more defendant-friendly system with a more defendant-friendly set of standards for determining what non-cancer injuries are compensable, what evidence of injury and exposure plaintiffs must produce, and what procedures courts should follow in considering asbestos personal injury claims.

Dr. Chambers predicts that in her system compensable non-cancer claims would fall by approximately 75% from their pre-petition levels. Her conclusion is based not on any actual tort system, but almost entirely upon the 2004 and 2005 experience of a single post-bankruptcy trust that was set up in the 1980's for claimants against Johns Manville. But the Manville Trust pays only five cents on the dollar to its successful claimants. Moreover, even Dr. Chambers acknowledges that the medical criteria provided in Manville Trust's distribution procedures to receive compensation from the Manville Trust are not those of state tort law generally applied in the 50 states. (Chambers Dep. Tr. at 197). Finally, despite Dr. Chambers' drastic culling of non-cancer claims to a remnant of what she describes as "higher quality" claims, she assumes that the

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mesothelioma and other asbestos-related disease will be very gradual. The UCC's other listed witness is Lester Brickman, a law professor, whose testimony about his view of the history of asbestos law and his medical and estimation theories is the subject of the Plan Supporters' pending *In Limine* motion.

values of such claims would, notwithstanding their "higher quality," actually be lower than the average paid in the years before Armstrong filed its petition.

When it comes to mesothelioma cases, Dr. Chambers equally departs from reality. She assumes that mesothelioma claims would decrease far faster than is justified by any recognized epidemiological model or Armstrong's past experience. Moreover, she postulates that Armstrong would be able to settle those future mesothelioma claims it did receive for barely half of what it had been paying on mesothelioma claims in 2000, its last year before filing for bankruptcy. Apart from being based on the erroneous premise that Armstrong's 2000 mesothelioma costs were inflated solely by the withdrawal from the CCR of one of its members, GAF,[22] Dr. Chambers' analysis wholly ignores the actual post-petition experience of defendants that have remained in the tort system – and even that of the Manville Trust, whose experience she regards as highly predictive in the non-cancer context – who have all experienced increases in mesothelioma claims and costs after 2000. In short, Dr. Chambers' estimate completely

[22] The evidence will show that CCR lawyers were successful in reducing the amounts its members paid when CCR settled a case on behalf of all its members to reflect GAF's withdrawal, which left it a free-standing defendant throughout the remaining period before Armstrong filed. Moreover, the evidence will show that Armstrong's payments in cases where GAF was a defendant were not significantly different, and actually somewhat lower, than in cases where GAF was not a defendant, making it clear that Armstrong was not paying anything extra to "make up" for GAF's share after GAF left the CCR.

departs from the framework of the American legal system and the practical facts of asbestos tort litigation.

CONCLUSION

Based on the evidence to be presented at the hearing, this Court should conclude that the Plan does not discriminate unfairly against the unsecured commercial creditors.

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Respectfully submitted,

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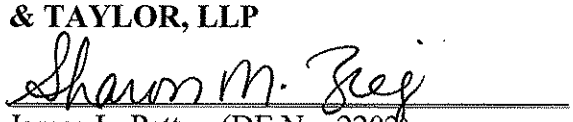

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