

Armstrong Holdings Inc.

Armstrong Holdings Inc. (NYSE: ACK)
2500 Columbia Ave.
Lancaster, PA 17603
Phone: 717-397-0611
Fax: 888-446-8061
Website: <http://www.armstrong.com>

Employees:	16,700
Revenue:	\$ 3,135,400,000
Net Income:	\$ 92,800,000
Assets:	\$ 4,034,400,000
Liabilities:	\$ 5,631,600,000
Estimated Asbestos Claims:	\$ 800,000,000

(For the year ended December 31, 2002)

Business Description: Armstrong World Industries Inc., the main operating unit of Armstrong Holdings Inc., makes interior finishing building materials such as floor coverings and acoustical ceiling and grid systems.

Asbestos Discussion from SEC filings:

From the Company's Form 10-K for the period ending December 31, 2002 at
<http://www.sec.gov/Archives/edgar/data/1109304/000095010903001451/d10k.txt>
Filed On: March 19, 2003

AWI is a defendant in personal injury cases and property damage cases related to asbestos containing products. On December 6, 2000, AWI filed a voluntary petition for relief ("the Filing") under Chapter 11 of the U.S. Bankruptcy Code to use the court supervised reorganization process to achieve a final resolution of its asbestos liability.

Asbestos-Related Personal Injury Claims
Prior to filing for relief under the Bankruptcy Code, AWI was a member of the Center for Claims Resolution (the "Center") which handled the defense and settlement of asbestos-related personal injury claims on behalf of its members. The Center pursued broad-based settlements of asbestos-related personal injury claims under the Strategic Settlement Program ("SSP") and had reached agreements with law firms that covered approximately 130,000 claims that named AWI as a

defendant. Due to the Filing, holders of asbestos-related personal injury claims are stayed from continuing to prosecute pending litigation and from commencing new lawsuits against AWI. In addition, AWI ceased making payments to the Center with respect to asbestos-related personal injury claims, including payments pursuant to the outstanding SSP agreements. AWI's obligations with respect to payments called for under these settlements will be determined in its Chapter 11 Case.

A creditors' committee representing the interests of asbestos personal injury claimants and an individual has been appointed to represent the interests of future personal injury claimants in the Chapter 11 Case. AWI's present and future asbestos liability will be addressed in its Chapter 11

Case rather than through the Center and a multitude of lawsuits in different jurisdictions throughout the U.S. It is anticipated that all of AWI's current and future asbestos-related personal injury claims will be resolved in the Chapter 11 Case.

Asbestos-Related Personal Injury Liability
In evaluating its potential asbestos-related personal injury liability prior to the Filing, AWI reviewed information provided by the Center including, among other things, recent and historical settlement amounts, the incidence of past and recent claims, the mix of the injuries of the plaintiffs, the number of cases pending against it and the status and results of broad-based settlement discussions. Based on this review, AWI developed an estimated range for its cost to defend and resolve asbestos-related personal injury claims for six years, through 2006. This estimated range was large due to the limitations of the available data and the difficulty of forecasting with any certainty the numerous variables that could have affected AWI's actual liability for this period. AWI concluded that no amount within the range was more likely than any other, and therefore reflected the low end of the range as the liability in the consolidated financial statements, in accordance with generally accepted accounting principles.

It is expected that the Chapter 11 process will deal with all current and future asbestos-related personal injury claims against AWI. There are significant differences between the way the asbestos-related personal injury claims may be addressed under the bankruptcy process and the historical way AWI's claims were resolved. See Note 1 of the Consolidated Financial Statements for further discussion on how the Chapter 11 process may address AWI's asbestos-related

personal injury claims.

As of September 30, 2000, AWI had recorded a liability of \$758.8 million for its asbestos-related personal injury liability that it determined was probable and estimable through 2006. Due to the increased uncertainty created as a result of the Filing, the only change made to the previously recorded liability through the third quarter of 2002 was to record October and November 2000 payments of \$68.2 million against the accrual. The asbestos-related personal injury liability balance recorded at December 31, 2001 was \$690.6 million, which was recorded in liabilities subject to compromise.

As discussed previously, AWI filed an initial POR and disclosure statement with respect to the POR during the fourth quarter of 2002. In March 2003, AWI filed an amended POR and disclosure statement. The POR represents the product of negotiations with and is supported by the Asbestos Personal Injury Claimants' Committee, the Unsecured Creditors' Committee and the Future Claimants' Representative. Based upon the foregoing, the discussions AWI has had with representatives of such entities within the last several months and the hearings held before the Court in the last several months, management now believes that it is reasonably likely that the claims addressed in the POR will be satisfied substantially in the manner set forth in the POR. As a result, AWI has concluded that it can reasonably estimate its probable liability for asbestos-related current and future personal injury claims. Accordingly, in the fourth quarter of 2002, AWI recorded a \$2.5 billion charge to increase the liability. The asbestos-related liability of approximately \$3.2 billion at December 31, 2002, which was treated as subject to compromise,

represents the estimated amount of liability that is implied based upon the negotiated resolution reflected in the POR, the total consideration expected to be paid to the Asbestos PI Trust pursuant to the POR and a recovery value percentage for the allowed claims of the Asbestos PI Trust that is equal to the estimated recovery value percentage for the allowed non-asbestos unsecured claims. Pursuant to the POR, all current and future asbestos-related personal injury claims will be channeled to the Asbestos PI Trust for resolution and, upon emergence from Chapter 11, reorganized AWI will not have any responsibility for the claims or participate in their resolution.

AWI is unable to predict when and if this POR will be confirmed. Therefore, the timing and terms of resolution of the Chapter 11 Case remain uncertain. As long as this uncertainty exists, future changes to the recorded liability are possible and could be material to AWI's financial position and the results of its operations. Management will continue to review the recorded liability in light of future developments in the Chapter 11 Case and make changes to the recorded liability if and when it is appropriate.

The \$2.5 billion, fourth quarter 2002, charge to increase the asbestos-related personal injury liability is before recognition of gains from the settlement of liabilities subject to compromise, which will arise at a later date as a consequence of the Chapter 11 process.

Collateral Requirements

During 2000, AWI had secured a bond for \$56.2 million to meet minimum collateral requirements established by the Center with respect to asbestos-related personal injury claims asserted against AWI. On October 27, 2000, the insurance company that

underwrote the surety bond informed AWI and the Center of its intention not to renew the surety bond effective February 28, 2001. On February 6, 2001, the Center advised the surety of the Center's demand for payment of the face value of the bond. The surety filed a motion with the Court seeking to restrain the Center from drawing on the bond. The motion was not granted. On March 28, 2001, the surety filed an amended complaint in the Court seeking similar relief. The Center has filed a motion to dismiss the amended complaint. The Court has not yet ruled on the Center's motion or the complaint. In addition, on April 27, 2001, AWI filed a complaint and a motion with the Court seeking an order, among other things, enjoining the Center from drawing on the bond or, in the event the Center is permitted to draw on the bond, requiring that the proceeds of any such draw be deposited into a Court-approved account subject to further order of the Court. Judge Alfred M. Wolin of the Federal District Court for the District of New Jersey, who is also presiding over AWI's Chapter 11 Case, indicated he would determine these matters. Judge Wolin has not yet ruled on these matters.

Asbestos-Related property Damage Litigation

Over the years, AWI was one of many defendants in asbestos-related property damage claims that were filed by public and private building owners, with six claims pending as of June 30, 2001. The claims that were resolved prior to the Filing resulted in aggregate indemnity obligations of less than \$10 million. To date, all payments of these obligations have been entirely covered by insurance. The pending cases present allegations of damage to the plaintiffs' buildings

caused by asbestos-containing products and generally seek compensatory and punitive damages and equitable relief, including reimbursement of expenditures for removal and replacement of such products. In the second quarter of 2000, AWI was served with a lawsuit seeking class certification of Texas residents who own property with asbestos-containing products. This case includes allegations that AWI asbestos-containing products caused damage to buildings and generally seeks compensatory damages and equitable relief, including testing, reimbursement for removal and diminution of property value. AWI vigorously denies the validity of the allegations against it in these actions and, in any event, believes that any costs will be covered by insurance.

Continued prosecution of these actions and the commencement of any new asbestos property damage actions are stayed due to the Filing. In March 2002, the Court allowed certain alleged holders of asbestos property damage claims to file a class proof of claim against AWI. In July 2002, the Court denied the certification of the proposed class and held that the plaintiffs' proof of claim shall only be effective as to the named claimants. The plaintiffs' motion for leave to appeal to the U.S. District Court was denied by Judge Wolin on October 3, 2002. As part of determining whether AWI asbestos containing resilient floor covering products give rise to property damage liability, the Court conducted an initial hearing on September 26 - 27, 2002 to decide the type of scientific testing allowable under the Federal Rules of Evidence to prove or disprove whether such products cause building contamination. On October 22, 2002, the Court granted AWI's requested relief and ruled that the methodology offered by the Asbestos Property Damage Committee in support of its claims is not a scientifically

valid method of quantifying the level of asbestos contamination in a building. On November 1, 2002, the Court directed that all property damage claimants provide, in support of their claims, substantiation that Armstrong flooring products were used in the claimants' buildings. The Court's deadline for submission of such product identification documentation was February 10, 2003. Prior to the Court's deadline, AWI reached an agreement in principle to settle approximately 360 property damage claims, which alleged damages of \$0.2 billion, for \$2 million. Any amounts to be paid are expected to be funded by insurance. This settlement is subject to the Court's approval, which is scheduled to be heard by the Court on April 4, 2003. Additionally, 130 property damage claims have been disallowed or withdrawn. Approximately 100 property damage claims totaling \$0.6 billion will remain unresolved if the settlement is approved. Only 26 of these 100 remaining property damage claims submitted product identification by the February 10, 2003 deadline referred to above.

Consistent with prior periods and due to increased uncertainty, AWI has not recorded any liability related to asbestos-related property damage claims as of December 31, 2002. See Note 1 of the Consolidated Financial Statements for further discussion of property damage claims in the Chapter 11 Case. A separate creditors' committee representing the interests of property damage asbestos claimants has been appointed in the Chapter 11 Case.

Insurance Recovery Proceedings

A substantial portion of AWI's primary and excess remaining insurance asset is nonproducts (general liability) insurance for personal injury claims, including among others, those that

involve alleged exposure during AWI's installation of asbestos insulation materials. AWI has entered into settlements with a number of the carriers resolving its coverage issues. However, an alternative dispute resolution ("ADR") procedure was commenced against certain carriers to determine the percentage of resolved and unresolved claims that are nonproducts claims, to establish the entitlement to such coverage and to determine whether and how much reinstatement of prematurely exhausted products hazard insurance is warranted. The nonproducts coverage potentially available is substantial and includes defense costs in addition to limits.

During 1999, AWI received preliminary decisions in the initial phases of the trial proceeding of the ADR, which were generally favorable to AWI on a number of issues related to insurance coverage. However, during the first quarter of 2001, a new trial judge was selected for the ADR. The new trial judge conducted hearings in 2001 and determined not to rehear matters decided by the previous judge. In the first quarter of 2002, the new trial judge concluded the ADR trial proceeding with findings in favor of AWI on substantially all key issues. Liberty Mutual, the only insurer that is still a party to the ADR, has appealed that final judgment. Appellate argument originally scheduled for October 2002 was adjourned and was held on March 11, 2003. In July 2002, AWI filed a lawsuit against Liberty Mutual in the Federal District Court for the Eastern District of Pennsylvania seeking, among other things, a declaratory judgment with respect to certain policy issues not subject to binding ADR.

One of the insurance carriers, Reliance Insurance Company, was placed under an

order of liquidation by the Pennsylvania Insurance Department during October 2001 due to financial difficulties. The order of liquidation prohibits Reliance from making any claim payments under the insurance policies until the liquidation occurs. AWI intends to file a proof of claim against Reliance by the December 2003 deadline. It is uncertain when AWI will receive proceeds from Reliance under these insurance policies.

Another insurer, Century Indemnity Company, who previously settled its coverage issues with AWI, has made some of its required payments under the settlement to a trust of which AWI is a beneficiary. During January 2002, this insurer filed an adversary action in AWI's Chapter 11 Case. Among other things, the action requests the Court to (1) declare that the settlement agreement is an executory contract and to compel assumption or rejection of the agreement; (2) declare that the insurer need not make its present and future scheduled payments unless AWI assumes the agreement; (3) declare that the insurer is entitled to indemnification from AWI against any liabilities that the insurer may incur in certain unrelated litigation in which the insurer is involved; and (4) enjoin the disposition of funds previously paid by the insurer to the trust pending an adjudication of the insurer's rights. These issues are before the Court for determination and AWI believes it is highly unlikely the insurer will prevail in this matter.

On March 5, 2003, the New Hampshire Insurance Department placed The Home Insurance Company ("Home") under an order of rehabilitation. Less than \$10 million of AWI's recorded insurance asset is based on policies with Home, which management believes is still probable of recovery.

Insurance Asset

An insurance asset in respect of asbestos personal injury claims in the amount of \$198.1 million is recorded as of December 31, 2002 compared to \$214.1 million as of December 31, 2001. Of the total recorded asset at December 31, 2002, approximately \$35.7 million represents partial settlement for previous claims that will be paid in a fixed and determinable flow and is reported at its net present value discounted at 6.50%. The total amount recorded reflects AWI's belief in the availability of insurance in this amount, based upon AWI's success in insurance recoveries, settlement agreements that provide such coverage, the nonproducts recoveries by other companies and the opinion of outside counsel. Such insurance is either available through settlement or probable of recovery through negotiation, litigation or resolution of the ADR process. Depending on further progress of the ADR, activities such as settlement discussions with

insurance carriers party to the ADR and those not party to the ADR, the final determination of coverage shared with ACandS (the former AWI insulation contracting subsidiary that was sold in August 1969 and which filed for relief under Chapter 11 of the Bankruptcy Code in September 2002) and the financial condition of the insurers, AWI may revise its estimate of probable insurance recoveries. Approximately \$80 million of the \$198.1 million asset is determined from agreed coverage in place and is therefore directly related to the amount of the liability. Of the \$198.1 million asset, \$24.0 million has been recorded as a current asset as of December 31, 2002 reflecting management's estimate of the minimum insurance payments to be received in the next 12 months. As of February 2003, approximately \$8.0 million of the \$24.0 million current asset is past due based on a previous settlement agreement.

AWI believes collection of the full amount is still probable and therefore has not established a reserve against these receivables.

A significant part of the recorded asset relates to insurance that AWI believes is probable and will be obtained through settlements with the various carriers. Although AWI revised its recorded asbestos liability by \$2.5 billion in the fourth quarter of 2002, there was no increase recorded in the estimated insurance recovery asset. While AWI believes that the process of resolving disputed insurance coverage may result in higher settlement amounts than recorded, there has been no increase in the recorded amounts due to the uncertainties remaining in the process. Accordingly, this asset could change significantly based upon resolution of the issues. Management estimates that the timing of future cash payments for the recorded asset may extend beyond 10 years.

Cash Flow Impact

As a result of the Chapter 11 Filing, AWI did not make any payments for asbestos-related claims in 2002 or 2001. AWI received \$16.0 million and \$32.2 million in asbestos-related insurance recoveries during 2002 and 2001, respectively. During the pendency of the Chapter 11 Case, AWI does not expect to make any further cash payments for asbestos-related claims, but AWI expects to continue to receive insurance proceeds under the terms of various settlement agreements.

Conclusion

Based upon the events described above, management came to a belief that AWI's asbestos-related liability will be settled substantially in the manner set forth in the POR. As a result, AWI recorded

a \$2.5 billion charge to increase its estimate of probable asbestos-related liability to approximately \$3.2 billion at December 31, 2002, which was treated as subject to compromise. The fourth quarter charge was determined by calculating an implied liability based upon the provisions of the POR and Disclosure Statement. However no change was made to the estimated asbestos-related insurance recovery asset. Many uncertainties continue to exist about the matters impacting AWI's asbestos-related liability and insurance asset. These uncertainties include the impact of the Filing and the Chapter 11 process, the number of future claims to be filed, the ultimate value of the asbestos liability, the impact of any potential legislation, the impact of the ADR proceedings on the insurance asset and the financial condition

of AWI's insurance carriers. Additionally, although a POR and Disclosure Statement have been filed with the Court, implementation of the POR is subject to confirmation of the POR in accordance with the provisions of the Bankruptcy Code. AWI is unable to predict when and if the POR will be confirmed. Therefore, the timing and terms of resolution of the Chapter 11 Case remain uncertain. As long as this uncertainty exists, future changes to the recorded liability and insurance asset are possible and could be material to AWI's financial position and the results of its operations. Management will continue to review the recorded liability and insurance asset in light of future developments in the Chapter 11 Case and make changes to the recorded amounts if and when it is appropriate.

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended March 31, 2003

<http://www.sec.gov/Archives/edgar/data/1109304/000102140803007274/d10q.htm>

Filed On: May 9, 2003

ASBESTOS-RELATED LITIGATION

The following is a summary update of asbestos-related litigation; see Item 3 of AHI's 2002 Form 10-K filing for additional information.

AWI is a defendant in personal injury cases and property damage cases related to asbestos containing products. On December 6, 2000, AWI filed a voluntary petition for relief ("the Filing") under Chapter 11 of the U.S. Bankruptcy Code to use the court supervised reorganization process to achieve a final resolution of its asbestos liability.

Asbestos-Related Personal Injury Claims

Prior to filing for relief under the Bankruptcy Code, AWI was a member of

the Center for Claims Resolution (the "Center") which handled the defense and settlement of asbestos-related personal injury claims on behalf of its members. The Center pursued broad-based settlements of asbestos-related personal injury claims under the Strategic Settlement Program ("SSP") and had reached agreements with law firms that covered approximately 130,000 claims that named AWI as a defendant.

Due to the Filing, holders of asbestos-related personal injury claims are stayed from continuing to prosecute pending litigation and from commencing new lawsuits against AWI. In addition, AWI

ceased making payments to the Center with respect to asbestos-related personal injury claims, including payments pursuant to the outstanding SSP agreements. AWI's obligations with respect to payments called for under these settlements will be determined in its Chapter 11 Case.

A creditors' committee representing the interests of asbestos personal injury claimants and an individual representing the interests of future personal injury claimants have been appointed in the Chapter 11 Case. AWI's present and future asbestos liability will be addressed in its Chapter 11 Case rather than through the Center and a multitude of lawsuits in different jurisdictions throughout the U.S. It is anticipated that all of AWI's current and future asbestos-related personal injury claims will be resolved in the Chapter 11 Case.

Asbestos-Related Personal Injury Liability

In March 2003, AWI filed an amended Plan of Reorganization and disclosure statement and in April 2003, AWI filed a further amended Plan of Reorganization ("POR"). The POR represents the product of negotiations with and is supported by the Asbestos Personal Injury Claimants' Committee, the Unsecured Creditors' Committee and the Future Claimants' Representative. Based upon the events that occurred through early March 2003, management concluded that it could reasonably estimate its probable liability for asbestos-related current and future personal injury claims. Accordingly, in the fourth quarter of 2002, AWI recorded a \$2.5 billion charge to increase the liability. The recorded asbestos-related liability of approximately \$3.2 billion at March 31, 2003 and December 31, 2002, which was treated as subject to compromise, represents the estimated amount of liability that is implied based

upon the negotiated resolution reflected in the POR, the total consideration expected to be paid to the Asbestos PI Trust pursuant to the POR and a recovery value percentage for the allowed claims of the Asbestos PI Trust that is equal to the estimated recovery value percentage for the allowed non-asbestos unsecured claims. Pursuant to the POR, all current and future asbestos-related personal injury claims will be channeled to the Asbestos PI Trust for resolution and, upon emergence from Chapter 11, reorganized AWI will not have any responsibility for the claims or participate in their resolution.

AWI is unable to predict when and if this POR will be confirmed. Therefore, the timing and terms of resolution of the Chapter 11 Case remain uncertain. As long as this uncertainty exists, future changes to the recorded liability are possible and could be material to AWI's financial position and the results of its operations. Management will continue to review the recorded liability in light of future developments in the Chapter 11 Case and make changes to the recorded liability if and when it is appropriate.

The \$2.5 billion, fourth quarter 2002, charge to increase the asbestos-related personal injury liability was before recognition of gains from the settlement of liabilities subject to compromise, which will arise at a later date as a consequence of the Chapter 11 process.

Collateral Requirements

During 2000, AWI had secured a bond for \$56.2 million to meet minimum collateral requirements established by the Center with respect to asbestos-related personal injury claims asserted against AWI. On October 27, 2000, the insurance company that underwrote the surety bond informed

AWI and the Center of its intention not to renew the surety bond effective February 28, 2001. On February 6, 2001, the Center advised the surety of the Center's demand for payment of the face value of the bond. The surety filed a motion with the Court seeking to restrain the Center from drawing on the bond. The motion was not granted. On March 28, 2001, the surety filed an amended complaint in the Court seeking similar relief. In addition, on April 27, 2001, AWI filed a complaint and a motion with the Court seeking an order, among other things, enjoining the Center from drawing on the bond or, in the event the Center is permitted to draw on the bond, requiring that the proceeds of any such draw be deposited into a Court-approved account subject to further order of the Court. Judge Alfred M. Wolin of the Federal District Court for the District of New Jersey (the "District Court"), who is also presiding over AWI's Chapter 11 Case, indicated he would determine these matters. In the spring of 2002, the surety and the Center agreed to voluntarily dismiss the surety's complaint against the Center in light of AWI's filing of its complaint. The parties filed cross-motions for summary judgment with respect to the issue of whether the Center is entitled to draw on the surety bond. On March 28, 2003, the District Court granted in part the Center's motion for summary judgment, and rejected certain defenses to the Center's attempt to draw on the surety bond. The District Court further ruled that the surety bond did not cover settlements with asbestos claimants that were not documented as of the Filing. On April 7, 2003, the Center filed a motion, which is still pending, to vacate that portion of the District Court's opinion that ruled that the surety bond does not cover any settlement not documented as of the Filing. The District Court will determine at a future date what amount, if any, the Center will be allowed to draw on the surety bond. If the Center is

allowed to draw on the surety bond, the surety's claim against AWI will be channeled to the Asbestos PI Trust. See Note 2 for further discussion of the Asbestos PI Trust. The District Court has requested additional briefing on AWI's argument that the surety bond is invalid for failure to include a material term.

Asbestos-Related Property Damage Litigation

Over the years, AWI was one of many defendants in asbestos-related property damage claims that were filed by public and private building owners, with six claims pending as of June 30, 2001. The claims that were resolved prior to the Filing resulted in aggregate indemnity obligations of less than \$10 million. To date, all payments of these obligations have been entirely covered by insurance. The pending cases present allegations of damage to the plaintiffs' buildings caused by asbestos-containing products and generally seek compensatory and punitive damages and equitable relief, including reimbursement of expenditures for removal and replacement of such products. In the second quarter of 2000, AWI was served with a lawsuit seeking class certification of Texas residents who own property with asbestos-containing products. This case includes allegations that AWI asbestos-containing products caused damage to buildings and generally seeks compensatory damages and equitable relief, including testing, reimbursement for removal and diminution of property value. AWI vigorously denies the validity of the allegations against it in these actions and, in any event, believes that any costs will be covered by insurance.

Continued prosecution of these actions and the commencement of any new asbestos property damage actions are stayed due to the Filing. In March 2002, the Court allowed certain alleged

holders of asbestos property damage claims to file a class proof of claim against AWI. In July 2002, the Court denied the certification of the proposed class and held that the plaintiffs' proof of claim shall only be effective as to the named claimants. The plaintiffs' motion for leave to appeal to the U.S. District Court was denied by Judge Wolin on October 3, 2002. As part of determining whether AWI asbestos containing resilient floor covering products give rise to property damage liability, the Court conducted an initial hearing on September 26 - 27, 2002 to decide the type of scientific testing allowable under the Federal Rules of Evidence to prove or disprove whether such products cause building contamination. On October 22, 2002, the Court granted AWI's requested relief and ruled that the methodology offered by the Asbestos Property Damage Committee in support of its claims is not a scientifically valid method of quantifying the level of asbestos contamination in a building. On November 1, 2002, the Court directed that all property damage claimants provide, in support of their claims, substantiation that Armstrong flooring products were used in the claimants' buildings. The Court's deadline for submission of such product identification documentation was February 10, 2003. Prior to the Court's deadline, AWI reached an agreement in principle to settle approximately 360 property damage claims, which alleged damages of \$0.2 billion, for \$2 million, which will be funded by insurance. The Court approved this settlement on April 4, 2003. Approximately 100 property damage claims totaling \$0.6 billion remain unresolved. Only 26 of these 100 remaining property damage claims submitted product identification by the February 10, 2003

deadline referred to above and AWI has filed an objection with the Court regarding the approximately 75 claims without product identification. Although AWI continues to vigorously defend any asserted asbestos-related property damage claims in the Court, AWI is negotiating to settle all of the remaining property damage claims.

Consistent with prior periods and due to uncertainty, AWI has not recorded any liability related to asbestos-related property damage claims as of March 31, 2003. See Note 2 for further discussion of property damage claims in the Chapter 11 Case. A separate creditors' committee representing the interests of property damage asbestos claimants has been appointed in the Chapter 11 Case.

Insurance Recovery Proceedings

A substantial portion of AWI's primary and excess remaining insurance asset is nonproducts (general liability) insurance for personal injury claims, including among others, those that involve alleged exposure during AWI's installation of asbestos insulation materials. AWI has entered into settlements with a number of the carriers resolving its coverage issues. However, an alternative dispute resolution ("ADR") procedure was commenced against certain carriers to determine the percentage of resolved and unresolved claims that are nonproducts claims, to establish the entitlement to such coverage and to determine whether and how much reinstatement of prematurely exhausted products hazard insurance is warranted. The nonproducts coverage potentially available is substantial and includes defense costs in addition to limits.

During 1999, AWI received preliminary decisions in the initial phases of the trial proceeding of the ADR, which were generally favorable to AWI on a number of issues related to insurance coverage. However, during the first quarter of 2001, a new trial judge was selected for the ADR. The new trial judge conducted hearings in 2001 and determined not to rehear matters decided by the previous judge. In the first quarter of 2002, the new trial judge concluded the ADR trial proceeding with findings in favor of AWI on substantially all key issues. Liberty Mutual, the only insurer that is still a party to the ADR, has appealed that final judgment. Appellate argument originally scheduled for October 2002 was adjourned and was held on March 11, 2003. In July 2002, AWI filed a lawsuit against Liberty Mutual in the Federal District Court for the Eastern District of Pennsylvania seeking, among other things, a declaratory judgment with respect to certain policy issues not subject to binding ADR.

One of the insurance carriers, Reliance Insurance Company, was placed under an order of liquidation by the Pennsylvania Insurance Department during October 2001 due to financial difficulties. The order of liquidation prohibits Reliance from making any claim payments under the insurance policies until the liquidation occurs. AWI intends to file a proof of claim against Reliance by the December 2003 deadline. It is uncertain when AWI will receive proceeds from Reliance under these insurance policies.

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action requests the Court to (1) declare that the settlement agreement is an executory contract and to compel assumption or rejection of the agreement; (2) declare that the insurer need not make its present and future scheduled payments unless AWI assumes the agreement; (3) declare that the insurer is entitled to indemnification from AWI against any liabilities that the insurer may incur in certain unrelated litigation in which the insurer is involved; and (4) enjoin the disposition of funds previously paid by the insurer to the trust pending an adjudication of the insurer's rights. These issues are before the Court for determination and AWI believes it is highly unlikely the insurer will prevail in this matter.

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Insurance Asset

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negotiation, litigation or resolution of the ADR process. Depending on further progress of the ADR, activities such as settlement discussions with insurance carriers party to the ADR and those not party to the ADR, the final determination of coverage shared with ACandS (the former AWI insulation contracting subsidiary that was sold in August 1969 and which filed for relief under Chapter 11 of the Bankruptcy Code in September 2002) and the financial condition of the insurers, AWI may revise its estimate of probable insurance recoveries. Approximately \$79 million of the \$198.1 million asset is determined from

agreed coverage in place and is therefore directly related to the amount of the liability. Of the \$198.1 million asset, \$24.0 million has been recorded as a current asset as of March 31, 2003 reflecting management's estimate of the minimum insurance payments to be received in the next 12 months. As of April 2003, approximately \$8.0 million of the \$24.0 million current asset is past due based on a previous settlement agreement. AWI believes collection of the full amount is still probable and therefore has not established a reserve against these receivables.

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended September 30, 2002

<http://www.sec.gov/Archives/edgar/data/1109304/000095010902005562/d10q.htm>

Filed On: November 8, 2002

ASBESTOS-RELATED LITIGATION

The following is a summary update of asbestos-related litigation; see Item 3 of Armstrong's 2001 Form 10-K filing for additional information.

AWI is a defendant in personal injury claims and property damage claims related to asbestos containing products. On December 6, 2000, AWI filed a voluntary petition for relief ("the Filing") under Chapter 11 of the U.S. Bankruptcy Code to use the court supervised reorganization process to achieve a final resolution of its asbestos liability.

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Prior to filing for relief under the Bankruptcy Code, AWI was a member of the Center for Claims Resolution (the "Center") which handled the defense and settlement of asbestos-related personal injury claims on behalf of its members. The Center pursued broad-based settlements of

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Chapter 11 Case. AWI's present and future asbestos liability will be addressed in its Chapter 11 Case rather than through the Center and a multitude of lawsuits in different jurisdictions throughout the U.S. It is anticipated that all of AWI's present and future asbestos-related personal injury claims will be resolved in the Chapter 11 Case.

Asbestos-Related Personal Injury Liability

In evaluating its potential asbestos-related personal injury liability prior to the Filing, AWI reviewed information provided by the Center including, among other things, recent and historical settlement amounts, the incidence of past and recent claims, the mix of the injuries of the plaintiffs, the number of cases pending against it and the status and results of broad-based settlement discussions. Based on this review, AWI developed an estimated range for its cost to defend and resolve asbestos-related personal injury claims for six years, through 2006. This estimated range was large due to the limitations of the available data and the difficulty of forecasting with any certainty the numerous variables that could have affected AWI's actual liability for this period. AWI concluded that no amount within the range was more likely than any other, and therefore reflected the low end of the range as the liability in the condensed consolidated financial statements, in accordance with generally accepted accounting principles.

It is expected that the Chapter 11 process will deal with all current and future asbestos-related personal injury claims against AWI. There are significant differences between the way the asbestos-related personal injury claims may be addressed under the bankruptcy process and the historical way AWI's claims were resolved. See Note 2 for further discussion on how the Chapter 11 process may address

AWI's asbestos-related personal injury claims. Therefore, AWI is unable to accurately predict what the Chapter 11 process will determine is AWI's total liability and AWI is unable to reasonably estimate a range of liability for asbestos-related personal injury claims. As of September 30, 2000, AWI had recorded a liability of \$758.8 million for its asbestos-related personal injury liability that it determined was probable and estimable through 2006. Due to the increased uncertainty created as a result of the Filing, no change has been made to the previously recorded liability except to record payments of \$68.2 million against that accrual in October and November 2000. The asbestos-related personal injury liability balance recorded at September 30, 2002 and December 31, 2001 is \$690.6 million, which is recorded in liabilities subject to compromise. If the POR, as described in Note 2, is confirmed and becomes effective, AWI would record a pre-tax charge in excess of \$2.4 billion, net of insurance coverage, to increase its Subject to Compromise liability. This charge would be before recognition of gains from the settlement of liabilities, which will arise out of the Chapter 11 process. However, at this time, AWI is unable to predict when and if the POR will be confirmed. Therefore, the timing and terms of resolution of the Chapter 11 Case remain uncertain. Accordingly, AWI has not adjusted its asbestos-related personal injury liability during the third quarter of 2002. It is likely that the total liability as determined in the Chapter 11 process will be significantly higher than the recorded liability and the liability will be material to the financial statements.

Collateral Requirements

During 2000, AWI had secured a bond for \$56.2 million to meet minimum collateral requirements

established by the Center with respect to asbestos-related personal injury claims asserted against AWI. On October 27, 2000, the insurance company that underwrote the surety bond informed AWI and the Center of its intention not to renew the surety bond effective February 28, 2001. On February 6, 2001, the Center advised the surety of the Center's demand for payment of the face value of the bond. The surety filed a motion with the Court seeking to restrain the Center from drawing on the bond. The motion was not granted. On March 28, 2001, the surety filed an amended complaint in the Court seeking similar relief. The Center has filed a motion to dismiss the amended complaint. The Court has not yet ruled on the Center's motion or the complaint. In addition, on April 27, 2001, AWI filed a complaint and a motion with the Court seeking an order, among other things, enjoining the Center from drawing on the bond or, in the event the Center is permitted to draw on the bond, requiring that the proceeds of any such draw be deposited into a Court-approved account subject to further order of the Court. Judge Alfred M. Wolin of the Federal District Court for the District of New Jersey, who is also presiding over AWI's Chapter 11 Case, indicated he would determine these matters. Judge Wolin has not yet ruled on these matters.

Asbestos-Related Property Damage Litigation

Over the years, AWI was one of many defendants in asbestos-related property damage claims that were filed by public and private building owners, with six claims pending as of June 30, 2001. The claims that were resolved prior to the Filing resulted in aggregate indemnity obligations of less than \$10 million. To date, all payments of these obligations have been entirely covered by insurance. The pending cases present

allegations of damage to the plaintiffs' buildings caused by asbestos-containing products and generally seek compensatory and punitive damages and equitable relief, including reimbursement of expenditures for removal and replacement of such products. In the second quarter of 2000, AWI was served with a lawsuit seeking class certification of Texas residents who own property with asbestos-containing products. This case includes allegations that AWI asbestos-containing products caused damage to buildings and generally seeks compensatory damages and equitable relief, including testing, reimbursement for removal and diminution of property value. AWI vigorously denies the validity of the allegations against it in these actions and, in any event, believes that any costs will be covered by insurance. Continued prosecution of these actions and the commencement of any new asbestos property damage actions are stayed due to the Filing. In March 2002, the Court allowed certain alleged holders of asbestos property damage claims to file a class proof of claim against AWI. In July 2002, the Court denied the certification of the proposed class and held that the plaintiffs' proof of claim shall only be effective as to the named claimants. As part of determining whether AWI asbestos containing resilient floor covering products give rise to property damage liability, the Court conducted an initial hearing on September 26 - 27, 2002 to decide the type of scientific testing allowable under the Federal Rules of Evidence to prove or disprove whether such products cause building contamination. On October 22, 2002, the Court granted AWI's requested relief and ruled that the methodology offered by the Asbestos Property Damage Committee in support of its claims is not a scientifically valid method of quantifying the

level of asbestos contamination in a building. On November 1, 2002, the Court directed that all property damage claimants provide, in support of their claims, substantiation that Armstrong flooring products were used in the claimants' buildings.

Consistent with prior periods and due to increased uncertainty, AWI has not recorded any liability related to these claims as of September 30, 2002. See Note 2 for further discussion of property damage claims in the Chapter 11 Case. A separate creditors' committee representing the interests of property damage asbestos claimants has been appointed in the Chapter 11 Case.

Insurance Recovery Proceedings

A substantial portion of AWI's primary and excess remaining insurance asset is nonproducts (general liability) insurance for personal injury claims, including among others, those that involve alleged exposure during AWI's installation of asbestos insulation materials. AWI has entered into settlements with a number of the carriers resolving its coverage issues. However, an alternative dispute resolution ("ADR") procedure was commenced against certain carriers to determine the percentage of resolved and unresolved claims that are nonproducts claims, to establish the entitlement to such coverage and to determine whether and how much reinstatement of prematurely exhausted products hazard insurance is warranted. The nonproducts coverage potentially available is substantial and includes defense costs in addition to limits.

During 1999, AWI received preliminary decisions in the initial phases of the trial proceeding of the ADR, which were

generally favorable to AWI on a number of issues related to insurance coverage. However, during the first quarter of 2001, a new trial judge was selected for the ADR. The new trial judge conducted hearings in 2001 and determined not to rehear matters decided by the previous judge. In the first quarter of 2002, the new trial judge concluded the ADR trial proceeding with findings in favor of AWI on substantially all key issues. Liberty Mutual, the only insurer that is still a party to the ADR, has appealed that final judgment. Appellate argument originally scheduled for October 2002 was adjourned and has not yet been rescheduled. In July 2002, AWI filed a lawsuit against Liberty Mutual in the Federal District Court for the Eastern District of Pennsylvania seeking, among other things, a declaratory judgment with respect to certain policy issues not subject to binding ADR.

One of the insurance carriers, Reliance Insurance Company, was placed under an order of liquidation by a state insurance department during October 2001 due to financial difficulties. The order of liquidation prohibits Reliance from making any claim payments under the insurance policies until the liquidation occurs. AWI intends to file a proof of claim against Reliance by the December 2003 deadline. It is uncertain when AWI will receive proceeds from Reliance under these insurance policies.

Another insurer (Century Indemnity Company), who previously settled its coverage issues with AWI, has made some of its required payments under the settlement to a trust of which AWI is a beneficiary. During January 2002, this insurer filed an adversary action in AWI's Chapter 11

Case. Among other things, the action requests the Court to (1) declare that the settlement agreement is an executory contract and to compel assumption or rejection of the agreement; (2) declare that the insurer need not make its present and future scheduled payments unless AWI assumes the agreement; (3) declare that the insurer is entitled to indemnification from AWI against any liabilities that the insurer may incur in certain unrelated litigation in which the insurer is involved; and (4) enjoin the disposition of funds previously paid by the insurer to the trust pending an adjudication of the insurer's rights. These issues are before the Court for determination and AWI believes it is highly unlikely the insurer will prevail in this matter.

Insurance Asset

An insurance asset in respect of asbestos personal injury claims in the amount of \$198.1 million is recorded as of September 30, 2002 compared to \$214.1 million as of December 31, 2001. Of the total recorded asset at September 30, 2002, approximately \$35.6 million represents partial settlement for previous claims that will be paid in a fixed and determinable flow and is reported at its net present value discounted at 6.50%. The total amount recorded reflects AWI's belief in the availability of insurance in this amount, based upon AWI's success in insurance recoveries, recent settlement agreements that provide such coverage, the nonproducts recoveries by other companies and the opinion of outside counsel. Such insurance is either available through settlement or probable of recovery through negotiation, litigation or resolution of the ADR process. Depending on further

progress of the ADR, activities such as settlement discussions with insurance carriers party to the ADR and those not party to the ADR, the final determination of coverage shared with ACandS (the former AWI insulation contracting subsidiary that was sold in August 1969 and which filed for relief under Chapter 11 of the Bankruptcy Code in September 2002) and the financial condition of the insurers, AWI may revise its estimate of probable insurance recoveries. Approximately \$80 million of the \$198.1 million asset is determined from agreed coverage in place and is therefore directly related to the amount of the liability. Of the \$198.1 million asset, \$24.0 million has been recorded as a current asset as of September 30, 2002 reflecting management's estimate of the minimum insurance payments to be received in the next 12 months.

A significant part of the recorded asset relates to insurance that AWI believes is probable and will be obtained through settlements with the various carriers. Due to the Filing, the settlement process may be delayed, pending further clarification as to the asbestos liability. While AWI believes the Chapter 11 process will strengthen its position on resolving disputed insurance and may therefore result in higher settlement amounts than recorded, there has been no increase in the recorded amounts due to the uncertainties created by the Filing. Accordingly, this asset could also change significantly based upon events which occur in the Court. Management estimates that the timing of future cash payments for the recorded asset may extend beyond 10 years.

Asbestos Discussion from SEC filings:

From the Company's Form 10-Q for the quarter ended June 30, 2002

<http://www.sec.gov/Archives/edgar/data/1109304/000095010902003970/d10q.txt>

Filed On: August 8, 2002

OVERVIEW OF ASBESTOS-RELATED
LEGAL PROCEEDINGS

Asbestos-related Litigation

The following is a summary update of asbestos-related litigation; see Item 3 of Armstrong's 2001 Form 10-K filing for additional information.

AWI is a defendant in personal injury claims and property damage claims related to asbestos containing products. On December 6, 2000, AWI filed a voluntary petition for relief ("the Filing") under Chapter 11 of the U.S. Bankruptcy Code to use the court supervised reorganization process to achieve a final resolution of its asbestos liability.

Asbestos-Related Personal Injury Claims

Prior to filing for relief under the Bankruptcy Code, AWI was a member of the Center for Claims Resolution (the "Center") which handled the defense and settlement of asbestos-related personal injury claims on behalf of its members. The Center pursued broad-based settlements of asbestos-related personal injury claims under the Strategic Settlement Program ("SSP") and had reached agreements with law firms that covered approximately 130,000 claims that named AWI as a defendant.

Due to the Filing, holders of asbestos-related personal injury claims are stayed from continuing to prosecute pending litigation and from commencing new lawsuits against AWI. In addition, AWI ceased making payments to the Center with respect to asbestos-related personal injury claims, including payments pursuant to the

outstanding SSP agreements. AWI's obligations with respect to payments called for under these settlements will be determined in its Chapter 11 Case.

A creditors' committee representing the interests of asbestos personal injury claimants has been appointed in the Chapter 11 Case. AWI's present and future asbestos liability will be addressed in its Chapter 11 Case rather than through the Center and a multitude of lawsuits in different jurisdictions throughout the U.S. It is anticipated that all of AWI's present and future asbestos-related personal injury claims will be resolved in the Chapter 11 Case.

Asbestos-Related Personal Injury Liability

In evaluating its potential asbestos-related personal injury liability prior to the Filing, AWI reviewed information provided by the Center including, among other things, recent and historical settlement amounts, the incidence of past and recent claims, the mix of the injuries of the plaintiffs, the number of cases pending against it and the status and results of broad-based settlement discussions. Based on this review, AWI developed an estimated range for its cost to defend and resolve asbestos-related personal injury claims for six years, through 2006. This estimated range was large due to the limitations of the available data and the difficulty of forecasting with any certainty the numerous variables that could have affected AWI's actual liability for this period. AWI concluded that no amount within the range was more likely than any other, and therefore reflected the low end of the range as the liability in the condensed

consolidated financial statements, in accordance with generally accepted accounting principles.

It is expected that the Chapter 11 process will deal with all current and future asbestos-related personal injury claims against AWI. There are significant differences between the way the asbestos-related personal injury claims may be addressed under the bankruptcy process and the historical way AWI's claims were resolved. Therefore, AWI is unable to accurately predict what the Chapter 11 process will determine is AWI's total liability nor reasonably estimate a range of liability for asbestos-related personal injury claims.

As of September 30, 2000, AWI had recorded a liability of \$758.8 million for its asbestos-related personal injury liability that it determined was probable and estimable through 2006. Due to the increased uncertainty created as a result of the Filing, no change has been made to the previously recorded liability except to record payments of \$68.2 million against that accrual in October and November 2000. The asbestos-related personal injury liability balance recorded at June 30, 2002 and December 31, 2001 is \$690.6 million, which is recorded in liabilities subject to compromise. It is likely that the total liability as determined in the Chapter 11 process will be significantly higher than the recorded liability and the liability will be material to the financial statements.

Collateral Requirements

During 2000, AWI had secured a bond for \$56.2 million to meet minimum collateral requirements established by the Center with respect to asbestos-related personal injury

claims asserted against AWI. On October 27, 2000, the insurance company that underwrote the surety bond informed AWI and the Center of its intention not to renew the surety bond effective February 28, 2001. On February 6, 2001, the Center advised the surety of the Center's demand for payment of the face value of the bond. The surety filed a motion with the Court seeking to restrain the Center from drawing on the bond. The motion was not granted. On March 28, 2001, the surety filed an amended complaint in the Court seeking similar relief. The Center has filed a motion to dismiss the amended complaint. The Court has not yet ruled on the Center's motion or the complaint. In addition, on April 27, 2001, AWI filed a complaint and a motion with the Court seeking an order, among other things, enjoining the Center from drawing on the bond or, in the event the Center is permitted to draw on the bond, requiring that the proceeds of any such draw be deposited into a Court-approved account subject to further order of the Court. Judge Alfred M. Wolin of the Federal District Court for the District of New Jersey, who is also presiding over AWI's Chapter 11 Case, indicated he would determine these matters. Judge Wolin has not yet ruled on these matters.

Asbestos-Related property Damage Litigation

Over the years, AWI was one of many defendants in asbestos-related property damage claims that were filed by public and private building owners, with six claims pending as of June 30, 2001. The claims that were resolved prior to the Filing resulted in aggregate indemnity obligations of less than \$10 million. To date, all payments of these obligations have been entirely

covered by insurance. The pending cases present allegations of damage to the plaintiffs' buildings caused by asbestos-containing products and generally seek compensatory and punitive damages and equitable relief, including reimbursement of expenditures for removal and replacement of such products. In the second quarter of 2000, AWI was served with a lawsuit seeking class certification of Texas residents who own property with asbestos-containing products. This case includes allegations that AWI asbestos-containing products caused damage to buildings and generally seeks compensatory damages and equitable relief, including testing, reimbursement for removal and diminution of property value. AWI vigorously denies the validity of the allegations against it in these actions and, in any event, believes that any costs will be covered by insurance. Continued prosecution of these actions and the commencement of any new asbestos property damage actions are stayed due to the Filing. In March 2002, the Court allowed certain alleged holders of asbestos property damage claims to file a class proof of claim against AWI. In July 2002, the Court denied the certification of the proposed class and held that the plaintiffs' proof of claim shall only be effective as to the named claimants. As part of determining whether AWI asbestos containing resilient floor covering products give rise to property damage liability, the Court will conduct an initial hearing on September 26 - 27, 2002 to decide the type of scientific testing allowable under the Federal Rules of Evidence to prove or disprove whether such products cause building contamination.

Consistent with prior periods and due to increased uncertainty, AWI has not recorded any liability related to these claims as of June 30, 2002. See Note 2 for further discussion of the property damage claims in

response to the August 31, 2001 claims bar date in the Chapter 11 Case. A separate creditors' committee representing the interests of property damage asbestos claimants has been appointed in the Chapter 11 Case.

Insurance Recovery Proceedings

A substantial portion of AWI's primary and excess remaining insurance asset is nonproducts (general liability) insurance for personal injury claims, including among others, those that involve alleged exposure during AWI's installation of asbestos insulation materials. AWI has entered into settlements with a number of the carriers resolving its coverage issues. However, an alternative dispute resolution ("ADR") procedure was commenced against certain carriers to determine the percentage of resolved and unresolved claims that are nonproducts claims, to establish the entitlement to such coverage and to determine whether and how much reinstatement of prematurely exhausted products hazard insurance is warranted. The nonproducts coverage potentially available is substantial and includes defense costs in addition to limits.

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insurer that is still a party to the ADR, has appealed that final judgment. Appellate argument is scheduled for October 2002. In July 2002, AWI filed a lawsuit against Liberty Mutual in the Federal District Court for the Eastern District of Pennsylvania seeking, among other things, a declaratory judgment with respect to certain policy issues not subject to binding ADR.

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Another insurer (Century Indemnity Company), who previously settled its

coverage issues with AWI, has made some of its required payments under the settlement to a trust of which AWI is a beneficiary. During January 2002, this insurer filed an adversary action in AWI's Chapter 11 Case. Among other things, the action requests the Court to (1) declare that the settlement agreement is an executory contract and to compel assumption or rejection of the agreement; (2) declare that the insurer need not make its present and future scheduled payments unless AWI assumes the agreement; (3) declare that the insurer is entitled to indemnification from AWI against any liabilities that the insurer may incur in certain unrelated litigation in which the insurer is involved; and (4) enjoin the disposition of funds previously paid by the insurer to the trust pending an adjudication of the insurer's rights. These issues are before the Court for determination and AWI believes it is highly unlikely the insurer will prevail in this matter.

Asbestos-Related News:

[Judge Won't Recuse Self From Armstrong Case \(Published March 28, 2003\)](#)

[AWI Notes \\$2.5B Asbestos Charge, Proposes Payout \(Published March 21, 2003\)](#)

[Bankruptcy Court OKs Armstrong's Shareholder Offer \(Published March 07, 2003\)](#)

[Groups Raise Objections To Armstrong Voting Plan \(Published February 28, 2003\)](#)

[AWI, Property Owners Agree on Asbestos Settlement \(Published February 14, 2003\)](#)

[Estimates \\$800 Million in Costs over Asbestos Claims \(Published September 06, 2002\)](#)

[Armstrong to Recover Funds from Asbestos Mediator \(Published October 18, 2002\)](#)

[Armstrong Files Plan of Reorganization in Ch. 11 Case \(Published November 08, 2002\)](#)