Legal Backgrounder

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# SOLVING THE GREAT ABSESTOS BANKRUPTCY HEIST

by

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As the prospects of reform in Congress continue to shift, America's asbestos liability mess continues to expand. Even if the trust fund approach currently being debated in Congress passed, the law would likely contain many potential traps that could set off a wave of new bankruptcies for businesses with asbestos liability exposure. With that in mind, this LEGAL BACKGROUNDER looks forward, addressing a common sense solution that could reduce the number of asbestos bankruptcies while also eliminating another problem not addressed in the trust fund proposal: the insidious pre-packaged bankruptcies controlled by asymptomatic claimants. It identifies simple amendments to section 524(g) of title 11 of the United States Code[1] that would eliminate the imbalance between symptomatic and asymptomatic asbestos claimants that has become the sad fact of recent asbestos bankruptcy cases.

***Federal Asbestos Reform***. Proposed asbestos trust fund legislation initially held[2] the prospect of certainty and finality. This was attractive to Wall Street, business and insurance interests. What was initially proposed as a $90 billion trust fund became, during one-sided negotiations, a $108 billion, and now, a $140 billion proposal. The additional $50 billion that the business and insurance communities added to the proposal failed to attract the support needed in the Senate. Election year politics put the trust fund proposal on hold for much of 2004.

Many assumed the changes in the Senate and House, and the reelection of President Bush in 2004, would clear the path for the enactment of the asbestos trust fund. In January 2005, new Judiciary Committee Chairman Arlen Specter circulated a discussion draft of his proposed asbestos trust fund legislation.[3] Attempting to attract bipartisan support, Senator Specter has sought to sweeten the pot by: (1) providing an escape hatch to state courts if the fund runs out of money, (2) loosening medical criteria, and (3) increasing attorneys' fees for plaintiffs' attorneys. These concessions have still failed to garner the necessary support in the Senate. These sweeteners, however, have soured a number of previously supportive Senators who threaten to pull their support.[4] In addition, key constituent groups, including some business and insurance interests, who negotiated to a stalemate against themselves for two years, are withdrawing support.[5] Senator Specter indicated recently[6] that if the deadlock does not break before Congress' spring recess, he would place the trust fund legislation in "deep freeze."

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It is useful to note that the asbestos trust fund legislation gained momentum because of both the thousands of asbestos lawsuits and the resulting asbestos-related bankruptcies. This article will not tackle the first of these issues, but proposes some commonsense solutions to the latter of these issues.

***Plan of Reorganization Approval***. Some background on Chapter 11 plan is necessary to understand the proposed solution. With some exceptions, a Chapter 11 debtor must receive a favorable vote from its creditors in order to confirm a plan of reorganization. Ballots are forwarded to creditors seeking their approval or rejection of the proposed plan. Votes are then tallied based on the classification of creditors set forth in the plan. Section 1126(c) provides that a class of claims has accepted a plan if at least two-thirds in amount and more than half in number of the allowed claims in the class vote to accept the plan.

***Who Can Vote on a Plan?*** Section 1126 and Rules 3017(c) and 3018[7] set forth procedural requirements for voting and make clear that only holders of "allowed claims" are entitled to vote on a Chapter 11 plan. Section 101(5) defines "claim" as a "right to payment" even if the amount of the claim is not liquidated or a judgment entered. Section 502 and Rules 3002 and 3003 govern "allowance" of claims. Pursuant to section 502, a proof of claim[8] is deemed allowed unless a party in interest objects to it. Rule 3002 is more direct: "an unsecured creditor . . . must file a proof of claim . . . to be allowed." Rule 3003 clarifies that a creditor need not file a proof of claim if its claim is listed as undisputed in the debtor's schedules.[9] As a third alternative, a creditor that does not meet either of the first two criteria may seek temporary allowance of its claim for purposes of voting.[10] Thus, creditors are entitled to vote if they: (1) file proofs of claim; (2) are scheduled as undisputed; or (3) are temporarily allowed to vote by Court order. No other party is entitled to vote on a debtor's plan.

***Section 524(g)***. Many people who have been exposed to asbestos fibers may not exhibit symptoms or become sick for many years after exposure. This has created difficulty identifying who has a present claim and who has a future claim. To resolve this problem, Congress enacted section 524(g),[11] the Manville amendment, in 1994.[12]

Section 524(g) governs discharge of asbestos-related liabilities. A section 524(g) discharge[13] frees a debtor from all present and future asbestos claims. Confirmation of a section 524(g) asbestos plan requires approval of a supermajority of at least 75 percent of voting claimants whose *claims* are to be addressed by the trust.[14] In order to distinguish, present claims from future claims, section 524(g) introduces the concept of "demand."[15] Demands, or future claimants, are *not* entitled to vote.

***Asymptomatic Claimants***. The asbestos plaintiffs' bar has aggressively pursued new claimants and, allegedly through collusive and fraudulent behavior, has identified hundreds of thousands of asymptomatic claimants, also known as "unimpaired" or "non-malignant" claimants.[16] Asymptomatic claimants are people who allege exposure to asbestos, but who are *not* sick and who do not exhibit any symptoms of exposure.[17] Through, what some refer to as "litigation tourism" in the nation's numerous "judicial hellholes,"[18] some juries have given asymptomatic claimants judgments of millions of dollars, even though these types of claimants have no, or little, diminution in lung capacity or sickness whatsoever. This has blurred the lines between what was once believed to be a demand and what is now viewed as a claim. According to recent studies, about 80 to 90 percent of asbestos lawsuits have been filed by asymptomatic claimants.[19] A handful of plaintiffs' law firms control "inventories" of thousands of such lawsuits.

Courts addressing the current wave of asbestos bankruptcy cases have struggled with the distinction. In the *USG* case, the[1]n-presiding District Judge Alfred J. Wolin determined that the basic rule of federal

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bankruptcy is that state law governs the merits of claims.[20] The issue of voting by asymptomatic claimants will again be addressed in the *USG* bankruptcy case in a hearing before District Judge Joy F. Conti.[21] As commentators have noted, however, unimpaired claims are so unique that they should be treated as demands.[22]

***Section 524(g) Exposed***. The flood of asymptomatic claimants has turned section 524(g) on its ear. Simple math dictates that asymptomatic claimants can control the 75 percent vote necessary to confirm an asbestos-related plan. In fact, with dozens of pending asbestos bankruptcies, including a few that have confirmed section 524(g) plans, asymptomatic claimants have had ample opportunity to establish their primacy in this area. Indeed, these claimants have found bankruptcy to be an efficient way to achieve payouts quickly through the use of pre-packaged asbestos bankruptcy cases.[23] Typically, asymptomatic claimants, through their counsel, are able to negotiate a more favorable payout than what is provided to future claimants or to malignant claimants.[24] Indeed, the Combustion Engineering plan, which was recently overturned by the U.S. Court of Appeals for the Third Circuit, provided for disparate treatment as between asymptomatic claimants and malignant claimants, with asymptomatic claimants receiving a higher percentage recovery.[25] The asymptomatic claimants could achieve this because their numbers were sufficient to control the voting process. Therein lies the central weakness of section 524(g).

While in virtually all bankruptcy cases, claimants do not vote unless they meet the previously described prerequisite of holding an allowed claim, because of the administrative burden of having several hundred thousand proofs of claims filed in a bankruptcy case, bankruptcy courts have ignored this requirement in asbestos bankruptcy cases. Typically, plaintiffs' attorneys file lists of names of the people they represent and cast ballots for them. These people do not file claims, are not scheduled, nor are they temporarily allowed for voting purposes. There is no audit to verify that these people even exist, that they have exposure to the debtor's product, that counsel represents them, or that counsel has authority to cast their ballot. Thus, income and stock of major companies are redistributed to phantom claimants without a scintilla of probative evidence.

***The Quick Pay Option***. Asbestos trusts are governed by trust distribution procedures ("TDPs"), which normally include "quick pay options" pursuant to which a claimant can receive a nominal payment, without submission of any medical evidence. This is the second part of the great asbestos heist. Plaintiffs' attorneys can simply request the quick pay option for their asymptomatic clients. With only minimal procedural safeguards or verification, millions of dollars flow to asymptomatic claimants and their attorneys.

***A Possible Solution***. Businesses should not be forced into bankruptcy, and then required to surrender stock and future income to claimants who are not sick. The solution is two-fold. First, section 524(g) could be amended to clarify that asymptomatic claimants do not hold claims, but rather hold demands. If they are classified as demands, they will not be permitted to vote. This will completely eliminate extortionate "pre-packs" and give malignant claimants the seat at the negotiating table that they deserve, but have been denied. Second, quick pay options in asbestos trusts could be prohibited by requiring all claimants to establish a claim before receiving any payment. A significant percentage of asymptomatic claimants will never become sick, and hence, will never be able to establish a claim. Eliminating the quick pay option could create an inactive docket in section 524(g) trusts.

***Will It Work?*** Legislative efforts in various states have helped to reduce the number of lawsuits by asymptomatic claimants.[26] But the elimination of junk asbestos lawsuits cannot be achieved without revising section 524(g). Because of the liberal voting in asbestos bankruptcy cases, plaintiffs' attorneys can control asbestos defendants. By shutting off this source of income, pursuit of claims on behalf of people who are not sick will no longer be a paying proposition for the asbestos plaintiffs' bar. If only malignant asbestos lawsuits are filed, asbestos defendants will be able to provide fair compensation to those who are truly sick.If

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that results in a bankruptcy, at least those who are sick will control the future cases.

# ENDNOTES

1. Title 11 is the United States Bankruptcy Code. Unless otherwise noted, all "section" references herein are to the Bankruptcy Code.
2. Fairness in Asbestos Injury Resolution Act of 2004, S. 2290, 108th Cong. (2004) (initially proposed in 2003 as S. 1125).
3. 151 Cong. Rec. S1009-01 (daily ed. Feb. 7, 2005).
4. Reuters, *Asbestos Bill at Critical Stage, Specter Says* (Mar. 1, 2005), *available at* www.reuters.com.
5. *See* Tory Newmyer, *Asbestos Bill Under Strain: Alliance Between Companies, Insurers Seems to be Cracking, as reported in* ROLL CALL (Mar. 14, 2005), *available at* www.rollcall.com; *see also Defendant, Insurer Group Send Letter to Sen. Specter, Seek Alternative Solution, as reported in* Mealey's Asbestos Lit. Rep. Vol. 20, # 1 (Feb. 2005).
6. Sen. Arlen Specter, *The Asbestos Bill* (Mar. 1, 2005), *available at* www.washingtontimes.com.
7. Unless otherwise noted, all "rule" references herein are to the Federal Rules of Bankruptcy Procedure.
8. Pursuant to section 501, creditors may file proofs of claim.
9. Schedules are lists of a debtor's assets and liabilities, which a debtor must file pursuant to section 521.
10. Rule 3018(a).
11. The Bankruptcy Reform Act of 1994, § 111, Pub. Law 103-393, 108 Stat. 4106 (1994).
12. The procedure adopted in section 524(g) is modeled after the trust/injunction in the Johns-Manville case. *See Kane v. Johns-Manville Corp.*, 68 B.R. 618 (Bankr. S.D.N.Y. 1986), *aff'd in part, rev'd in part*, 78 B.R. 406 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636 (2d Cir. 1988).
13. Section 524(g) refers to this discharge as a channeling injunction, because all past and future asbestos-related claims are channeled to a trust for resolution and payment.
14. Section 524(g) includes numerous other requirements not relevant here.
15. A demand is a demand for payment that was not a claim during the pendency of the bankruptcy case.
16. *See* Robert J. Samuelson, *Asbestos Fraud*, WASH. POST, Nov. 20, 2002, at 25.
17. A good reference point for medical criteria is the ABA Standards for Non-Malignant Asbestos-Related Claims. *See The Asbestos Litigation Crisis Continues: It Is Time for Congress to Act*: *Hearing Before the Senate Judiciary Comm.*, 108th Cong. (Mar. 5, 2003).
18. Press Release, *Worst States for Liability Systems Are "Judicial Hellholes®,"* American Tort Reform Ass'n (Mar. 8, 2005), *available at* www.atra.org (referred to hereinafter as "ATRA Press Release").
19. *See* Stephen J. Carroll, et al., *Asbestos Litigation Costs and Compensation: An Interim Report*, Rand Institute for Civil Justice, August 2002, at 50. There are some indications that this number has gone down in the last two years. This may reflect the economic pressure facing plaintiffs' attorneys bringing large numbers of such claims, or it could reflect the ease with which plaintiffs' attorneys with large "inventories" of unimpaired claims are able to manipulate the bankruptcy system.
20. *See Official Comm. Of Asbestos Peres. Injury Claimants v. Sealed Air Corp. (In re W.R. Grace & Co.)*, 281 B.R. 852, 860 (Bankr. D. Del. 2002) (rejecting application of federal law to asbestos claims adopted in *Schweitzer v. Consolidated R.R. Co.*, 758 F.2d 936, 942, n. 3 (3d Cir.), *cert. denied*, 474 U.S. 864 (1985)); *In re USG Corp.*, 290 B.R. 223 (Bankr. D. Del. 2003) (citing *In re Frenville Co.*, 744 F.2d 332 (3d Cir.), *cert. denied*, 469 U.S. 1160 (1985)).
21. *See USG Corp. v. Perch (In re USG Corp.)*, Case No. 04-cv-1560 (D. Del.).
22. Mark D. Taylor and Scott L. Alberino, *Who Is Authorized to Vote on a Plan of Reorganization?: Issue pending in the USG Bankruptcy Case Could Alter the Asbestos Bankruptcy Landscape*, MEALEY'S ASBESTOS BANKR. Rep. Vol. 2, #6 (January 2003). *See also* William P. Shelley and Jacob C. Cohn, *Unraveling the Gordian Knot of Asymptomatic Claimants: Statutory, Precedential and Policy Reasons Why Unimpaired Asbestos Claimants Cannot Recovery in Bankruptcy*, MEALEY'S ASBESTOS BANKR. REP. Vol. 3, #10 (2004).
23. A "pre-pack" is a bankruptcy case in which the debtor negotiates and solicits acceptance of its plan from all or significant part of its creditors prior to filing a chapter 11 petition. Such cases, if successful, have the advantage of reducing the time and cost of a bankruptcy case. *See, e.g., In re Shook & Fletcher Insulation Co.*, Ch. 11 Case No. 02-02771 (Bankr. N.D. Ala. 2003) (pre-pack plan confirmed). *But see In re AcandS, Inc.*, 311 B.R. 36 (Bankr. D. Del. 2004) (Newsome, J.) (denying confirmation of pre-pack asbestos plan); *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004) (vacating confirmation of pre-pack plan).
24. Malignant claimants are the most seriously ill claimants, having, generally, either mesothelioma or lung cancer.
25. *See In re Combustion Eng'g*, 391 F.3d at 205.
26. *See* ATRA Press Release (discussing successful tort reform efforts in Mississippi and Texas). *See also* Jim Provance, *Taft Signs Bill Curbing Asbestos Suits* (June 4, 2004) (discussing Ohio inactive docket), *available at* www.toledoblade.com.

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