



Vol. 21 No. 15

April 21, 2006

USG SETTLEMENT REFLECTS SORRY STATE OF ASBESTOS BANKRUPTCIES

By

Mark D. Taylor and Brandi A. Richardson

On January 30, 2006, USG announced a settlement with its asbestos claimants that will now pave the way for its exit from Chapter 11.¹ Pursuant to the settlement, USG will fund a section 524(g) asbestos trust,² assuming the reorganization plan including these settlement terms is confirmed, with an initial payment of \$900 million in cash. If Congress fails to enact federal asbestos legislation, the FAIR Act,³ by the close of this year's legislative session, USG will contribute an additional \$3.05 billion note. USG's existing equity will pass through the bankruptcy, but will become available to the asbestos trust if USG defaults on its obligations under the note.

Wall Street initially greeted the news of the settlement with the "irrational exuberance" that has greeted virtually any positive announcement about asbestos legislation or asbestos-related debtors over the last five years. The stock price spiked by 20% in the two days after the announcement.⁴ USG's stock price has since pulled back from the levels it reached after the announcement of the settlement. As the market has digested the details of the settlement, there has been an increasing sense that the settlement is not necessarily good news.

Why? In short, because of how things have progressed over the last six years during the current wave of asbestos bankruptcies, and more particularly, because of USG's role in that progression. The

¹*In re USG Corp.*, Ch. 11 Case No. 01-2094 (Bankr. D. Del. 2006).

²11. U.S.C. § 524 (g).

³Fairness in Asbestos Injury Resolution Act of 2005 or the FAIR Act of 2005, S. 852, 109th Cong. (2005).

⁴Stock increased \$15.93 to \$95.78. Alexandra Twin, *Choppy day ahead of Fed* (Jan. 20, 2006) at <http://cnmmoney.com>.

Mark D. Taylor is a partner in the Financial Restructuring and Bankruptcy practice of Arent Fox PLLC where he represents debtors, Chapter 11 Trustees, and committees in asbestos related or other mass tort bankruptcies. **Brandi A. Richardson** is an associate in the General Litigation and Government Relations practices of Arent Fox PLLC. *The views expressed herein are those of the authors and do not necessarily reflect those of the Washington Legal Foundation. They should not be construed as an attempt to aid or hinder the passage of legislation.*

current wave of asbestos bankruptcies has included such mega-cases as *G-1 Holdings*,⁵ *Federal Mogul*,⁶ *Babcock & Wilcox*,⁷ *Armstrong World*,⁸ *Owens Corning*,⁹ *W.R. Grace*,¹⁰ and of course, *USG*. There have been numerous smaller asbestos bankruptcies, including pre-packaged bankruptcies, such as *J.T. Thorp*.¹¹ These bankruptcies have been characterized by the unparalleled influence of the unimpaired asbestos claimants, who, because they comprise up to ninety percent of the total asbestos claims pool, hold a blocking vote under the seventy-five percent requirement of section 524(g) of the Bankruptcy Code.

The issue of whether unimpaired claims holder hold “claims” under section 101 of the Bankruptcy Code,¹² or “demands” under section 524(g),¹³ is a matter of significant practical and policy concern. Holders of claims are entitled to vote on section 524(g) plans; holders of demands are not. The Bankruptcy and District Courts overseeing these cases have done little to clarify the issue. Notwithstanding the unstoppable momentum of unimpaired claims, *USG*, along with *W.R. Grace* and *G-1*, have stood firmly against any settlement with the unimpaired claimants. *Babcock & Wilcox* initially led the charge against payment of unimpaired claims, but eventually gave up the fight, settled, and emerged from Chapter 11 on February 22, 2006.¹⁴

⁵*In re G-1 Holdings, Inc.*, Ch. 11 Case No. 01-30135 (Bankr. D.N.J.).

⁶*In re Federal Mogul Global, Inc.*, Ch. 11 Case No. 01-10578 (Bankr. D. Del.).

⁷*In re Babcock & Wilcox Co.*, Ch. 11 Case No. 00-10992 (Bankr. E.D. La.)

⁸*In re Armstrong World Indus., Inc.*, Ch. 11 Case No. 00-04471 (Bankr. D. Del.).

⁹*In re Owens Corning*, Ch. 11 Case No. (Bankr. D. Del.).

¹⁰*In re W.R. Grace & Co.*, Ch. 11 Case No. 01-1139 (Bankr. D. Del.).

¹¹*In re J T Thorpe Co.*, Ch. 11 Case No. 02-41487 (Bankr. S.D. Tex.).

¹²11 U.S.C. § 101(5). Section 101(5) defines “claim” as:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

¹³11 U.S.C. § 524(g)(5). Section 524(g)(5) defines “demand” as:

... a demand for payment, present or future, that—

- (A) was not a claim during the proceedings leading to the confirmation of a plan of reorganization;
- (B) arises out of the same or similar conduct or events that gave rise to the claims addressed by the injunction issued under paragraph (1); and
- (C) pursuant to the plan, is to be paid by a trust described in paragraph (2)(B)(i).

¹⁴News Release, *McDermott International Inc., The Babcock & Wilcox Company Exits Chapter 11 Bankruptcy; A Transformational Event for McDermott and B&W*, (Feb. 22, 2006) (on file with author).

Early reported decisions that sought to limit the influence of unimpaired claimants, such as the *Sealed Air* decision¹⁵ (involving fraudulent conveyances) and the *USG* decision¹⁶ (involving unimpaired claims), gave little hope to asbestos debtors like USG. However, recent Third Circuit opinions involving *Combustion Engineering*¹⁷ and *Congoleum*¹⁸ have signaled a return to a balanced approach to asbestos bankruptcies, in which asbestos plaintiffs would actually have to comply with the Bankruptcy Code. Wall Street and the legal community looked with anticipation upon the upcoming USG litigation, which sought a substantive estimation of its asbestos liability based on an analysis of 2000 asbestos claims. Thus, on the verge of what many expected to be a stunning victory, USG seemingly gave up the fight. Further, it settled for what many believed was more than twice its actual liability. Paying a settlement premium is not uncommon when taking into consideration the certainty that a settlement brings and the savings of administrative costs, but few would argue that a \$2 billion premium is a reasonable settlement premium.

Why did USG elect to settle, rather than fight? The answer apparently relates to USG's evaluation of its business prospects and of the prospects for enactment of the FAIR legislation in this Congress.

First, the amount of the USG settlement is significantly higher than the Wall Street estimate of USG's asbestos liability. When judged from a market share standpoint, against Owens Corning's court-estimated \$7.0 billion asbestos liability,¹⁹ many believed that the USG liability would be in the \$1.5 to \$2.5 billion range. Further, the substantive estimation trial mentioned above was widely regarded as a significant opportunity to restore the proper balance to these bankruptcy cases. Observers hoped the estimation trial would provide solid, and much needed, guidance regarding the allowability of non-malignant asbestos claims. Those who follow this closely were of the view that USG would prevail. USG was considered poised to obtain a significant victory in its Chapter 11; Wall Street investors were banking on it.

Second, many of the biggest asbestos debtors have delayed emergence from Chapter 11, because of the significant dividend available to the biggest debtors in the asbestos trust to be created by the FAIR

¹⁵*Official Comm. of Asbestos Pers. Injury Claimants v. Sealed Air Corp. (In re W.R. Grace & Co.)*, 285 B.R. 148 (Bankr. D. Del. 2002) (authorizing claimants committee to pursue fraudulent conveyance action despite contrary intervening authority).

¹⁶*In re USG Corp.*, 290 B.R. 223 (Bankr. D. Del. 2003) (refusing to conduct merit-based estimation of claims on grounds that debtors was insolvent even without disputed claims). The judge was unwilling to review unimpaired claims on the ground the mesothelioma claims against USG rendered it insolvent anyway. USG has turned out to be solvent after all. Further, the notion that the "mesos" swamp debtors is a pernicious notion that has never been conclusively established. By allowing this fallacious notion to persist, courts have not given any scrutiny to unimpaired claims.

¹⁷*In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3rd Cir. 2004) (overturning confirmation of debtor's pre-packaged plan).

¹⁸*Century Indem. Co. v. Congoleum Corp. (In re Congoleum Corp.)*, 426 F.3d 675 (3rd Cir. 2005) (disqualifying debtor's special insurance counsel and order disgorgement of \$13 million in fees).

¹⁹Company News; Owens Corning's Asbestos Liability is Set at \$7 Billion, Apr. 5, 2005, at <http://query.nytimes.com/gst/fullpage.html?res=9900E4DB1F3FF936A35757C0A9639C8B63>.

Act. For example, the USG settlement “exposes the multi-billion dollar windfall” that major companies, such as USG, could receive from the FAIR Act.²⁰ This major company dividend comes at the expense of smaller businesses. Further, it should give rise to grave concern that the proposed national asbestos trust may be significantly underfunded. A recent report by respected asbestos estimator Charles Bates of Bates White, LLC suggests that the fund might be underfunded by as much as \$500 billion.²¹ The fact that USG has now moved forward likely indicates its view that the FAIR Act will not pass.

Thus, while, on its face, the settlement seems far too rich, after five years in Chapter 11 USG was prepared to move on. The business is profitable and from the standpoint of equity values, not likely to get too much better. Further, even though USG paid a premium, it has protected itself not only from the legislative risk, but it has also preserved equity, an uncommon feat in asbestos bankruptcy.

From the asbestos plaintiffs’ perspective, USG gave them an offer they could not refuse. Serious doubts exist regarding whether the asbestos claimants could have obtained this result through the substantive estimation procedure. Further, although the FAIR Act is in doubt, the willingness of courts to scrutinize asbestos claims is not. As state legislative efforts have begun to take hold, perhaps the end of the apparently abusive practices of asbestos claims is nearing an end.

If so, we may look back on the USG settlement, not with dismay, but as a watershed moment.

²⁰Forbes PR Wire, *USG Agreement Exposes Multi-billion Dollar Windfall from Asbestos Bill*, Jan. 30, 2006, at <http://www.forbes.com/prnewswire/feeds/prnewswire/200601300170>.

²¹Charles Bates, Bates White, LLC, *Analysis of S. 852 Fairness in Asbestos Injury Resolution (FAIR) Act*, Sept. 2005, available at http://www.bateswhite.com/news/pdf/2005_Bates_FAIR_Act_report.pdf.