

**AMERICAN BANKRUPTCY INSTITUTE  
MID-ATLANTIC BANKRUPTCY WORKSHOP  
AUGUST 5-6, 2005**

**RECENT DEVELOPMENTS AFFECTING MASS TORT CASES**

**Using Chapter 11 to Litigate Your Asbestos Liabilities Away – Is It Permissible?**

Peter Van N. Lockwood  
Caplin & Drysdale, Chartered  
Washington, DC

In several pending asbestos bankruptcies (USG Corp., W.R. Grace and G-I Holdings), the debtors are attempting to effectively disallow large numbers of present and future asbestos personal injury claims through litigation procedures which would be unavailable outside bankruptcy. See, e.g., Amchem Products, Inc. v. Windsor, 521 U.S. 591 (1997) (factual differences among asbestos personal injury claimants preclude use of Rule 23 class action procedures to resolve a defendant's liability). See also Cimino v. Raymark Indus., Inc., 151 F.3d 297 (5<sup>th</sup> Cir. 1998) (rejecting a procedure to impose results in asbestos cases based on trials of test cases of the same general kind).

At least one of these debtors, USG Corp., asserts that it is very solvent (indeed the market value of its outstanding equity has recently exceeded \$1.5 billion) and that its primary goal in bankruptcy is to obtain a determination that the extent of its aggregate asbestos liabilities is sufficiently low that it can pay them off in full along with its other creditors and leave substantial value for its equity holders. W.R. Grace and G-I Holdings have made similar assertions.

Before addressing the legality and feasibility of the proposed litigation mechanisms, it should be noted that the Third Circuit has squarely held in the case of In re SGL Carbon Corp., 200 F.3d 154 (1999), that it is a ground for dismissing a Chapter 11 case for lack of good faith filing where a financially healthy company files for the purpose of gaining a tactical litigation

advantage over one or more of its creditors. That holding was reaffirmed in In re Integrated Telecom Express, Inc., 384 F.3d (3d Cir. 2004).

If one were to take the protestations of these debtors at face value there would appear to be ample grounds for dismissing their chapter 11 cases. However, so far they have been able to successfully carry water on both shoulders by contending that they have a real need for bankruptcy protection because of the financial distress to which they are being subjected by a “broken” tort system.

While the specific proposed litigation mechanisms in the cases differ somewhat, they share a common theme – the contention that a debtor can assert a right to estimate its global asbestos personal injury liability in a manner which will, in substantial part, require the bankruptcy court (or district court where the reference has been withdrawn on this subject) to make categorical declarations of the “validity” of entire classes of claims that the debtor challenges. Needless to say, the legality and feasibility of these strategies are being vigorously dispelled by the official committees of asbestos claimants (“ACCs”) and future claimants representatives (“FCRs”) in these cases.

The USG Corp. case presents the issue starkly. There the debtors (who include the USG parent and several subsidiaries, including United States Gypsum Co., the entity that is alleged to be the sole debtor with any asbestos liabilities) have moved for an aggregate estimation of their asbestos personal injury liabilities. Their proposal, which they call “substantive estimation”, is not the normal form of estimation which (as discussed more fully by my co-panelist Norman Pernick) typically involves experts using a debtor’s prior claims resolution history as a starting point for extrapolating its future liabilities. See, e.g., Eagle-Picher Indus., Inc., 189 B.R. 681

(Bankr. S.D. Ohio 1995); Owens Corning v. Credit Sunrise First Boston, 322 B.R. 719 (D. Del. 2005).

Rather the USG Debtors propose to focus the court's attention on the unresolved pending claims against them. The Debtors insist that they have "the right to test the merits of claims" in estimation and that the way to do that is for the Court to "hold an evidentiary hearing to determine the characteristics of valid claims". The Court should then "estimate at zero" those claims which do not satisfy the "set of criteria for claims predicted to be valid and payable". Next, following discovery, the parties will present testimony from "economic and statistical experts" who will apply the Court's "characteristics" ruling and "claimant discovery" to identify "the number of valid present claims, the number of valid future claims, the value the Court should assign to the estimated valid claims in each disease category and the aggregate value" of those claims.

In order to clarify the parties' dispute over the USG "substantive estimation" proposal, it may be helpful to back up a few steps to examine the use of estimation in bankruptcy.

It is true as a general proposition that a debtor has a right under section 502 of the Bankruptcy Code to "test the merits of claims" against it by objecting to such claims as they are filed (usually pursuant to a bar date process). However, invocation of that right to object initiates a contested matter under Bankruptcy Rules 9014 and 9015 (which incorporate many of the Federal Rules of Civil Procedure that are made applicable by Part VII of the Bankruptcy Rules). In addition, pursuant to 28 U.S.C. §§ 157(b)(2)(B) and (b)(5), personal injury claims must be tried in the District Court and 28 U.S.C. § 1411 preserves personal injury claimants' rights to a jury trial. The USG Debtors, however, are not seeking to object to the allowance of individual asbestos personal injury claims in the normal manner which would give the claimants the full

panoply of rights to contest the validity of any such objections. Rather, they contend, they are seeking to “estimate” those claims.

Section 502(c) of the Bankruptcy Code provides that in the case of “any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case such claim shall be estimated for purpose of allowance . . . .”

However, allowance of individual claims through contested estimation proceedings (which would likewise provide the individual claimants with Rule 9014 procedural and statutory jury trial rights) is not what the USG Debtors are seeking because (1) they had over 100,000 pending claims as of the petition date and (2) they must deal with future claims. Instead, the USG Debtors intend to utilize § 524(g) of the Bankruptcy Code to channel all their present and future asbestos personal injury claims to a trust that, following consummation of a plan of reorganization, will resolve and pay those claims. Thus, in its present posture, there will be no allowance or disallowance of asbestos personal injury claims in the USG bankruptcy case whether by means of a § 502(c) estimation or otherwise. Resolution of individual claims will be the function of the trust, post-consummation.

Instead, what the USG Debtors are nominally seeking is a form of estimation which has no specific Bankruptcy Code basis but originates with the concept that in a section 524(g) plan there must be some way of determining the share of the debtors’ assets that will go the trust to which the asbestos personal injury claims will all be channeled, coupled with the provision in 28 U.S.C. § 157(b)(2)(B) which includes as a core bankruptcy proceeding “the estimation of claims or interests for purposes of confirming a plan under chapter 11 . . . .” See In re Eagle-Picher Industries, Inc., 189 B.R. 681 (Bankr. S.D. Ohio 1995). This type of estimation involves a

determination of a debtor's aggregate asbestos personal injury liabilities (present and future) but does not determine the validity of any individual claims.

Section 524(g), however, because it was modeled on the Manville case, generally contemplates a consensual chapter 11 plan of reorganization with an aggregate estimation being utilized (1) either to demonstrate, in the event of confirmation objections, that the plan is fair and equitable to the holders of "demands" (future claimants) in light of the benefits provided to the trust by the debtor, § 524(g)(4)(B)(ii), or (2) to justify a cram-down over a dissenting creditor class by showing that the plan does not disseminate unfairly in favor of the asbestos trust beneficiaries and is fair and equitable to the dissenting class.

In the USG case, the stated reason for estimation is to determine the relative shares of the USG Debtors' estate that will go to the asbestos PI claimants on the one hand, and other creditors and equity interest holders, on the other, for the purpose of enabling the USG Debtors to propose a confirmable § 524(g) plan. For that, there has to be a measure of the relative size of the respective claims – and that means, for the asbestos PI claims, what it would likely have cost debtors to resolve those claims (both the pending ones and those to be filed at some time in the future) if they had remained in the tort system. See Owens Corning, 322 B.R. at 721-22.

The reason that every asbestos bankruptcy to date that has had an aggregate estimation take place has utilized the debtor's historic claims resolution data as its basis is because that data provides the largest and most reliable source of empirical evidence of what the debtor and its asbestos creditors actually valued those liabilities at in arm's-length transactions. First, as is the case with the USG Debtors, 99 percent of the claims against asbestos defendants in bankruptcy were resolved by settlements rather than as a result of trials and judgments. Thus, by definition, cases that resulted in verdicts, as experts will acknowledge, are by definition outliers – on the

one hand, as compared with settlements, there will be a substantially greater percentage of cases that result in defense wins and, on the other, the cases won by the plaintiffs generally produce far larger judgments than the average settlement amounts paid to claimants with similar claims. As a result, extrapolation of a defendant's liability based on its pre-petition claims history will overwhelmingly reflect the lower values and dismissal rates of its settlements rather than the higher values and dismissal rates of its verdicts and judgments. It will also reflect what everyone with any contact with the tort system knows – that most cases are not lay-downs for either side, but rather present risks and so can (and should) be settled for a compromise value that reflects each side's assessment of the risks. In general, extrapolation from verdicts and judgments will produce a much larger projected asbestos liability than from settlements – a result which conforms to the common sense notion that asbestos defendants acting in their own economic self interest will, over the 30-year history of asbestos litigation, have adopted a litigation strategy aimed at minimizing their costs which they will have employed in tens, if not hundreds, of thousands of cases pre-petition, as the USG Debtors did also.

The ACC and the FCR in the USG case are taking the position that estimation in that case should proceed on the same basic approach – take the history as a starting point. In contrast, what the USG Debtors propose to do has never been done before anywhere. As noted above, the core of the Debtors' proposal is that, under the guise of estimation, the Court should “determine the characteristics of valid claims” and thereafter experts can apply those determinations to a sampling of pending claims to establish by some sort of extrapolation the number and values of pending and future claims.

More specifically, the USG Debtors have identified 5 “defenses” which they contend they have a due process right to have the Court rule on categorically as part of their proposed claim validity determination:

- (1) Does chrysotile asbestos (allegedly the only type used in USG Debtors’ products) cause mesothelioma?
- (2) Can a claim for lung cancer based on exposure to asbestos be “valid” if unaccompanied by a diagnosis of asbestos?
- (3) Does asbestos cause cancers other than mesothelioma and lung cancer, such as colorectal, gastrointestinal, and laryngeal cancer?
- (4) Do “unimpaired” claimants – as the USG Debtors would define that term -- have valid claims?
- (5) What is the minimum duration and intensity of exposure to the Debtors’ asbestos containing products required for a “valid” claim and in what industries and occupations can such minimum exposure only have occurred?

Noteworthy in its absence from USG’s description of these defenses is the citation of any decided case from any court sustaining any of these defenses as a matter of fact and law or laying down bright line rules for claim validity of the sort demanded by these defenses. The fact is that these contentions have been known for decades and Debtors and other similarly situated defendants have had 30 years or so to establish the validity of these defenses in litigation. With the exception of a few states that deny recovery for pleural disease (and four state statutes enacted in 2004 and 2005 that set specific rules for non-malignancy claims), these defenses are not established state law requirements. To be sure, these defenses have been asserted in trials – but with, at best, very mixed results, and, moreover, they are invariably treated as questions of

fact for the jury to decide based on its views of the competing evidence including expert testimony.

Instead of demonstrating that these defenses are established in law – which would be impossible because they are not -- the USG Debtors have asked the court to determine these issues on the merits and on a global basis. Their proposal would force the ACC and the FCR, as proxies for tens of thousands of present and future claimants (whom they do not and cannot represent as individuals), to produce expert testimony on all these issues while the USG Debtors produce contrary experts and the court will then, acting as the trier of fact – or ad hoc legislature – decide for all such claimants which sets of experts are more credible. Based on those determinations, the court will then rule, if the USG Debtors prevail, that despite the fact the USG Debtors and/or other defendants have tried and lost these issues in numerous other case before other triers of fact, and with trivial exceptions, no state has enacted any of these propositions into statute or established them as governing tort law by court decision, that:

- (1) Nobody with mesothelioma has a valid claim against the USG Debtors;
- (2) Nobody with lung cancer but without diagnosed asbestosis has a valid claim against the USG Debtors;
- (3) Nobody with a cancer other than lung cancer has a valid claim against the USG Debtors;
- (4) Nobody who is “unimpaired”, as the court ultimately determines to define that term by reference to pulmonary testing, x-ray reading and/or any other diagnostic standard, has a valid claim against the USG Debtors under the laws of any of the 50 states; and

- (5) Nobody who is unable to demonstrate “sufficient exposure” to the USG Debtors’ asbestos containing products as determined by (i) a formula to be set by the court which multiplies the “intensity” of the exposure by the “duration” of the exposure and then (ii) establishes both the industries and occupations which could only have given rise to exposures satisfying the court-determined formula in (i) has a valid claim against the USG Debtors.

As their justification for their claimed entitlement to this process and these results, the USG Debtors repeatedly assert that it is “the claimants’ burden” to establish that the Debtors’ products have caused harm to them. While that burden might exist if a claimant filed a claim and the Debtors objected to its allowance, what the USG Debtors are trying to do is, in the guise of estimation, to make a global objection to every single pending asbestos claim and then, notwithstanding both the Bankruptcy Rules and the local rules in Delaware limiting omnibus objections, Del. Local Rule 3007-1, litigate the validity of that global objection with an official creditors committee and the futures representative rather than with the affected claimants themselves on a case by case basis (as those claimants would be entitled to).

And in an effort to show that their proposal is not claim disallowance, the USG Debtors are asserting that they are simply asking the Court to estimate these supposedly “invalid” claims at zero. In their argument the USG Debtors ignore the fact that any trust set up to resolve and pay individual claims under their expected § 524(g) reorganization plan would neither be funded nor authorized to pay claims that the Court had estimated to be worth zero because they were “invalid”. Thus it is hard to see why the Debtors’ zero estimation proposal is not effectively the omnibus disallowance of the so-called invalid claims.

In sum, the ultimate question being presented by the “substantive estimation” methodology for aggregate claims estimation in USG (and by similar approaches proposed in the W.R. Grace and G-I Holdings bankruptcies) is whether asbestos debtors can persuade the courts to ignore both (i) the general limitations on the mass adjudication of personal injury tort claims reflected in the Amchem and Cimino cases and (ii) the Bankruptcy Code and Rule procedures for claim disallowance, through use of a novel form of omnibus substantive claims objection by labeling it estimation.