Legal Backgrounder

WLF Washington Legal Foundation

Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302

Vol. 20 No. 33 July 29, 2005

COURT ISSUES KEY RULING ON ESTIMATING LIABILITY IN ASBESTOS BANKRUPTCIES

by

Mark D. Plevin and Leslie A. Epley

A federal district judge in the long-running *Owens Corning* bankruptcy case recently issued a significant opinion holding that when estimating the debtor's total post-bankruptcy liability for present and future asbestos personal injury claims, the results of company's pre-bankruptcy tort litigation had to be adjusted for seven factors which "skewed" the past results. The seven factors cited by the court were: venue shopping; mass screenings; suspect B-readers; overpayment to unimpaired claimants; the leveraging of serious claims to boost the value of unimpaired claims; the impact of "global" settlements; and punitive damages. *See Owens Corning v. Credit Suisse First Boston (In re Owens Corning)*, 322 B.R. 719 (D. Del. 2005). The opinion is an important step in limiting the power of asbestos claimants in asbestos bankruptcies.

Section 524(g) May Create a Need for Estimation of Current and Future Asbestos Claims. Since 1994, dozens of companies seeking refuge from asbestos liability have filed for bankruptcy to take advantage of a special provision of the Bankruptcy Code, 11 U.S.C. § 524(g), which permits a company that can satisfy the statute's requirements to cleanse itself of all current and future asbestos-related liability by "channeling" that liability to a trust established in a Chapter 11 plan of reorganization. One requirement of § 524(g) is that 75% of all voting asbestos claimants must vote in favor of the plan — an extraordinary grant of power to the claimants. Another requirement is that the trust must "value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner." A court may require an estimate of the total amount of the debtor's current and future asbestos-related liability as a precursor to making the required determination that the proposed trust funding will be adequate.

Estimating a Debtor's Asbestos Liability Can Significantly Impact the Course of a Bankruptcy Case. All creditors in a non-prepackaged asbestos bankruptcy — both asbestos claimants and other types of creditors — confront the reality that the debtor's assets constitute a limited fund from which they can be paid. Where the debtor has significant non-asbestos debt, the

---

Mark D. Plevin is a partner and **Leslie A. Epley** is an associate at the law firm of Crowell & Moring LLP in Washington, D.C. They frequently represent insurers in asbestos bankruptcies.

debtor's non-asbestos creditors will battle the asbestos constituencies to determine how the available assets should be divided. Current asbestos claimants and the court-appointed "future claimants' representative" (or "FCR") seek a high estimate of the debtor's total asbestos liability in order to maximize the trust's funding. Non-asbestos creditors seek a low estimate of the debtor's asbestos liability because any funds made available to the asbestos trust necessarily reduces their distribution. The debtor, needing to satisfy 75% of the voting asbestos claimants to obtain a § 524(g) "channeling injunction," can either acquiesce to the demands of the asbestos constituencies for a high estimate or, if their demands are not palatable, can litigate in hopes of obtaining a low estimate in order to preserve estate assets for non-asbestos creditors and shareholders. When the debtor and the competing creditor constituencies are unable to reach a compromise as to the debtor's current and future asbestos liability, an estimation proceeding may be required to resolve the dispute.

The Dispute over Owens Corning's Asbestos Liability. The *Owens Corning* bankruptcy illustrates this problem. One impediment to resolution of this bankruptcy, now pending nearly five years, has been the amount of the debtor's asbestos liability. Unlike some asbestos debtors, whose liabilities almost solely consist of asbestos claims, Owens Corning has extensive non-asbestos liabilities, including at least $3.7 billion in bank, bond, and trade debt. With the exception of some insurance proceeds that are potentially available to pay only covered asbestos claims, each dollar used to fund the asbestos trust is a dollar less for non-asbestos creditors, and vice versa. The recoveries of the banks, bondholders, and asbestos claimants would vary widely depending on the estimate of debtor's asbestos liability.

Rather than litigate against the asbestos constituencies, whose support it needs to confirm a plan, Owens Corning proposed a plan of reorganization dependent on a judicial finding that its aggregate asbestos liability was at least $16.1 billion — almost eight times larger than the company's $2.2 billion estimate at an earlier stage of the bankruptcy case.[1] The non-asbestos creditors and certain Owens Corning insurers hotly disputed the $16.1 billion figure.

The Owens Corning Estimation Proceeding. Earlier this year, Senior Judge John P. Fullam of Philadelphia, sitting by designation in the U.S. District Court for the District of Delaware, presided over a trial to estimate Owens Corning's total liability for current and future asbestos personal injury claims. The estimation proceeding was largely a battle of the experts, with expert testimony presented by the Asbestos Claimants Committee (the "ACC"), the FCR, and certain of Owens Corning's bank and bondholder creditors. The court made a preliminary ruling that the parties had to rely on Owens Corning's historical claims settlement data,[2] so it did not permit discovery into the actual claims pending against Owens Corning. The court's own opinion, however, explains why extrapolating from such historical claims data is not a reliable indicator of an asbestos debtor's liability.

The experts for the ACC and FCR estimated Owens Corning's liability for all pending and future asbestos-related personal injury claims at $11.1 billion and $8.15 billion, respectively, based on assumptions that the company's pre-bankruptcy asbestos litigation, including its payments for unimpaired claims and punitive damages, should guide the court in estimating the pending and future claims against the company.

---

[1] *See*, *e.g.*, Owens Corning SEC Form 10-Q for the Quarter Ended June 30, 2002, filed Aug. 12, 2002, at 28-37.

[2] *See* Order, Dkt. No. 8, *Owens Corning v. Credit Suisse First Boston*, No. 04-905 (JPF) (D. Del. Oct. 12, 2004).

  ISBN 1056 3059

In contrast, the expert for Owens Corning's bank creditors and bondholders estimated the company's total asbestos-related liability at $3.151 billion or less. This expert used Owens Corning's pre-bankruptcy claims values as a starting point but then, based on a "systematic study" of the company's pre-bankruptcy claims resolution history, adjusted these values to reflect changes between the pre-bankruptcy state court litigation and the federal judicial system, where the post-bankruptcy claims would now be resolved.

Owens Corning did not present any expert testimony, but the banks and bondholders called Owens Corning's expert as a witness. He estimated Owens Corning's total liability for current and future asbestos claims at $6.5-$6.8 billion. The banks and the bondholders argued that if the court did not accept their expert's estimate, it should accept the estimate of Owens Corning's expert because his analysis "considered the changed circumstances upon which Owens Corning's asbestos personal injury liabilities will now be determined."

Although Owens Corning asserted that it did "not advocate any particular valuation of [its] asbestos liability," it argued that court-approved asbestos liability estimates in two other bankruptcy cases, *Armstrong World Industries* ($4 billion) and *Babcock & Wilcox* ($8 billion), provided a "sanity check" for the estimation of Owens Corning's asbestos liability.

The District Court's Ruling on the Appropriate Estimation of Owens Corning's Asbestos Liability. On March 31, 2005, the district court issued its ruling estimating Owens Corning's present and future asbestos personal injury liability. The court noted that "[t]he overall task at this point in the litigation is to determine what each class of creditors has at stake." *In re Owens Corning*, 322 B.R. at 722. Although the claims of the banks and bondholders were fixed, the value of the asbestos claims was the amount the claimants, as a group, "had a legitimate right to expect as compensation for their injuries" as of the petition date *Id*. The court noted that it had much information about Owens Corning's past litigation history, but "some of the past results have been skewed by factors which can and should be avoided in the future." *Id*. at 722-23. The court ruled that there were seven "factors which are unlikely to be replicated" post-bankruptcy:

> 1. **Venue Shopping**: The filing of "huge numbers" of asbestos suits in "selected state jurisdictions (Mississippi, Texas, Southern Illinois) noted for 'runaway' jury verdicts.'" The court noted that "[u]ntil recently . . . plaintiffs could sue in Texas even though they themselves resided elsewhere, and had never been exposed to asbestos products in Texas."
>
> 2. **Mass Screenings**: "Labor unions, attorneys, and other persons with suspect motives caused large numbers of people to undergo X-ray examinations (at no cost), thus triggering thousands of claims by persons who had never experienced adverse symptoms."
>
> 3. **Erroneous X-ray Interpretations by "Suspect B-readers**:" B-readers are persons who read lung X-rays. Although "[t]he interpretation of lung X-rays is more of an art than a science," the court found that "[c]ertain pro-plaintiff B-readers were so biased that their readings were simply unreliable."
>
> 4. **Overpayment to "Unimpaired" Claimants**: "Juries tended to award damages to plaintiffs who proved exposure to asbestos . . . even though the claimant had never experienced adverse symptoms," and "defendants tended to" settle such claims "to avoid defense costs."
>
> 5. "**Group Lawsuits**:" Individual lawsuits often involved a "large group" of plaintiffs

  ISBN 1056 3059

including "both persons with mesothelioma and other serious diseases, and persons with minimal proof of liability and minimal or no symptoms." In such instances, the "presence of serious cases [such as mesothelioma] tended to result in higher verdicts or settlements for the 'unimpaired' cases."

6. **Global Settlements** "tended to over-value the less meritorious cases (and, perhaps, to encourage law firm efforts to recruit more claimants)."

7. **Punitive Damages**: Although the "dollar amount of verdicts and settlements pre-bankruptcy included, or may have been impacted by, punitive damages or the threat of such damages," it "seems highly doubtful that, in today's tort system, punitive damages would be allowed in any substantial amount, in most jurisdictions, to deter tortious conduct which ended more than twenty years ago."

Id. at 723.

The court evaluated each expert's forecast to determine which had best accounted for these factors. The court discounted the testimony of the banks' and bondholder's expert because it was "completely at odds with the testimony of the other experts." The court similarly discounted the testimony of the ACC's expert because he was at "the other extreme" and "failed adequately to take into account the changes in the asbestos litigation landscape which have already occurred and which will likely continue." The court found the opinions of Owens Corning's expert and the FCR's expert "equally persuasive" because both "largely succeeded in adjusting historical figures to reflect changed circumstances." Concluding that the "appropriate figure lies somewhere between" the estimates of these two experts, the court split the difference and estimated Owens Corning's total liability for asbestos-related personal injury claims at $7 billion – less than half the $16 billion required by Owens Corning's plan. *Id*. at 725.

The banks and bondholders have appealed the district court's decision, as did one of Owens Corning's insurers who participated in the estimation proceeding.

The court's recognition that the results of Owens Corning's pre-bankruptcy asbestos litigation had been skewed by the seven factors listed above, and therefore could not serve as a reliable basis to estimate its current and future asbestos liability, is significant. In most asbestos bankruptcy cases, the asbestos constituencies have argued vigorously that courts should rely exclusively on such skewed and unreliable data in estimating a debtor's current and future asbestos liability, thus perpetuating the problems of the past. While it can be argued that the court did not go far enough (*e.g.*, because it should have permitted discovery concerning the actual claims pending against Owens Corning and because it should have given more weight to the analysis of the banks' and bondholder's expert), the decision nevertheless provides strong support for the argument that past litigation results must be discounted in any estimate of a debtor's total current and future asbestos liability.

  ISBN 1056 3059