Section of Litigation Products Liability

Bankruptcy Trusts and Asbestos Litigation

By Lee Blanton Ziffer – June 11, 2012

As asbestos litigation stretches into its fifth decade, the largest mass tort in U.S. history has shown no signs of slowing down. Diagnoses of mesothelioma, a rare form of cancer linked to asbestos exposure, are at an all-time high, and some predict that the number will continue to grow well into the next decade. *See* BertramPrice & Adam Ware, "Mesothelioma Trends in the United States: An Update Based on Surveillance, Epidemiology, and End Results Program Data for 1973 through 2003," 159 *Am. J. Epidemiology* 107–12 (Issue No. 2, Jan. 15, 2004). By 2002, an estimated 730,000 people had filed asbestos-related lawsuits.

As liabilities for manufacturers that formerly used asbestos in their products continue to grow, many of the most prevalent asbestos litigation defendants have filed for bankruptcy reorganization. During confirmation proceedings, many of these companies have established asbestos personal injury trusts to pay claimants who allege to have been injured by exposure to asbestos-containing products. While the bankruptcy trust model has grown in usage and popularity among defendants faced with insurmountable asbestos liabilities, so have the number of trusts and so have problems associated with integrating trust compensation into the traditional tort system.

The Johns Manville Bankruptcy and Section 524(g)

When asbestos thermal insulation manufacturer Johns Manville filed for Chapter 11 protection in 1982, it was the single largest worldwide producer of asbestos-containing products, and it accounted for more than 50 percent of the asbestos-containing insulation sold worldwide. *Matter of Johns-Manville Corp.*, 68 B.R. 618 (Bankr. S.D.N.Y. 1986), *aff'd in part, rev'd in part*, *Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988). With asbestos litigation snowballing in the early 1980s, Johns Manville had been named in approximately 12,500 asbestos-exposure suits, brought on behalf of over 16,000 claimants, with new suits being filed at the rate of 425 per month. *Id.* Faced with an avalanche of asbestos liability, Johns Manville sought bankruptcy protection in 1982.

The Johns Manville bankruptcy proceedings created a model for other asbestos defendants to follow in discharging liabilities for asbestos claims through bankruptcy, including the creation of a settlement trust, funded by a majority of the bankrupt entity's stock, and for the express purpose of paying asbestos claimants for their injuries. Once confirmed by the court, the emerging trust became the only recourse for asbestos claimants with claims against Johns Manville, who were barred by injunction from pursuing claims against the reorganized company. *In re Joint Eastern & Southern Districts AsbestosLitig.*, 878 F. Supp. 473 (E.D.N.Y. 1995), *aff'd in part, vacated in part*, 78 F.3d 764 (2d Cir. 1996).

In 1994, Congress explicitly authorized what Johns Manville had achieved in its own bankruptcy proceedings in 1982 and enacted section 524(g) of the U.S. Bankruptcy Code to permit companies plagued by mass asbestos tort claims to establish and fund a trust to address and pay all present and future claims relating to liability for asbestos exposure. 11 U.S.C. § 524(g). Under section 524(g), once the entity emerges from bankruptcy, all liabilities for asbestos exposure are assigned to the

newly created trust, and the emerging entity is discharged of all asbestos-related liability. The trust distributes funds on the basis of Trust Distribution Procedures (TDPs), each of which has a schedule of diseases, along with exposure and medical criteria that a claimant must meet to receive a distribution. Once a claimant establishes that he or she is a trust beneficiary by satisfying the TDPs disease and exposure criteria, the claimant is entitled to have his or her claim paid out of the trust. 11 U.S.C. § 524(g); *see also In re Combustion Eng'g, Inc.*, 391 F.3d 190, 201 (3d Cir. 2004). Trusts are now paying out billions of dollars per year to claimants and, as of 2008, reported assets of approximately $30 billion. Lloyd S. Dixon & Geoffrey McGovern, *Asbestos Bankruptcy Trusts and Tort Compensation* 3 (RAND Inst. for Civil Justice 2011).

Since the enactment of section 524(g), dozens of companies have sought bankruptcy protection to resolve their asbestos liabilities globally. As of 2011, 56 such trusts have been confirmed on behalf of asbestos defendants that have declared bankruptcy, and payments from these trusts have risen rapidly. As of 2008, the largest 26 trusts had paid $10.9 billion on 2.4 million claims. A "conservative estimate" places the current assets of the trusts at "$35 billion . . . and potentially as much as $60 billion." Charles E. Bates & Charles H. Mullin, "Having Your Tort and Eating It Too?," *Mealey's Asbestos Bankr. Rep.*, Nov. 2006, at 21.

The frequency of bankruptcy filings due to asbestos litigation liabilities has steadily increased from 20 during the 1980s to at least 37 between January 2000 and summer 2004. Of the 29 companies that filed for bankruptcy between January 2000 and December 2002, six were valued at more than $1 billion: W. R. Grace, Owens Corning, Kaiser Aluminum, U.S. Gypsum Company (USG), Armstrong World Industries, and Federal-Mogul Corporation. Stephen J. Carroll et al., *Asbestos Litigation* 109 (RAND Inst. for Civil Justice 2005). As of March 2011, 96 companies with asbestos liabilities had filed for reorganization, although not all have yet emerged from bankruptcy proceedings having set up a trust. Dixon & McGovern, *supra*, at 2.

Although specific settlement information is largely unavailable due to confidentiality provisions in TDPs, total trust payments to asbestos claimants have been steadily growing, from $1.45 billion in 2007 to $3.36 billion in 2008 and $3.9 billion in 2009. It has become increasingly clear that the enactment of section 524(g) has had the unintended side effect of creating a well-funded, multi-billion dollar avenue of recovery for asbestos claimants. The asbestos mass tort has been fractured into two parallel and nonexclusive methods of recovery, which are both used by plaintiffs. Both systems allow a claimant to collect a substantial recovery for his or her injuries. Carroll, *supra*.

Problems with the Parallel System

Today, a large number of the most historically culpable defendants in asbestos litigation are protected from suit by channeling injunctions under 524(g). Given that these 524(g) trusts are answering for the liability of many of the most culpable companies and are, in fact, paying significant sums, logic suggests that the existence of settlement trusts would result in a reduction in the liabilities of solvent defendants that remain in the tort system. However, the opposite has occurred. In response to the departure of the major asbestos product manufacturers from the tort system, payments made by the remaining solvent defendants have increased, despite the growing number of settlement trusts coming online.

Commentators debate the exact causes of this increase, but most agree that a lack of coordination between the tort system and the trust system is to blame, including a lack of information sharing and the difficulty in properly assigning fault to bankrupt entities. For example, many 524(g) trust TDPs allow claimants to indefinitely delay making their claims, to a time after they recover from all tort system defendants, thereby allowing claimants to time their trust submissions to reap a full recovery in the tort system, only to double-dip from settlement trusts. Mark A. Behrens, "What's New in Asbestos Litigation," 28 *Rev. Litig.* 501, 550 (2009). In addition, many trust TDPs require that trusts keep the names of the claimants and the fact that their claims existed confidential. *See* William P. Shelley, Jacob C. Cohn & Joseph A. Arnold, "The Need for Transparency Between the Tort System and Section 524(g) Asbestos Trusts," 17 *Norton J. Bankr. L. & Prac.* 2, 3 (2008); *See also* Adrienne Bramlett Kvello, "The Best of Times and the Worst of Times," 40 *The Advoc.* (Texas) 80, 81 (2007).

These provisions allow claimants to strategically avoid identifying settlement trust defendants as sources of exposure in litigation and later to make claims against the trusts, making it difficult for solvent defendants to present third-party fault-related defenses or to obtain setoffs for trust payments. Because of delay and confidentiality provisions, defendants are often powerless to prove inconsistencies because they are not privy to trust claims, and trust claims are delayed until after resolution of the tort claims. Thus, plaintiffs can recover from solvent defendants, on the theory that exposure to those products caused their injuries, and later make claims against trusts, alleging that those products were the cause.

The severity of this problem varies widely across jurisdictions, at least partially due to differences in liability regimes and disclosure requirements. In comparative fault jurisdictions, where juries are allowed to assign liability to the universe of potential tortfeasors with each liable entity paying its share in proportion to its assigned percentage of fault, defendants can account for trust payments by presenting a case against bankrupt tortfeasors, reducing a judgment by the percentage assigned to the trusts. Conversely, in jurisdictions with joint and several liability regimes, non-party bankrupt entities are not normally allowed on the jury form, and each defendant found liable pays its pro rata share of the entire judgment, regardless of its percentage of fault. With many of the most culpable asbestos defendants, historically, immune from suit and liability apportionment, liability that should arguably be assigned to bankruptcy trusts is being borne wholly by the remaining solvent defendants.

Even in jurisdictions that do allow fault apportionment to bankruptcy trusts, disclosure requirements and flexibility in timing of trust submissions can operate in effect to conceal evidence necessary to present a case against a trust. Some jurisdictions, such as West Virginia, New York City, Pennsylvania, and Texas, require disclosure of trust submissions prior to trial, allowing a defendant to effectively prepare a case against the trusts. However, only New York City and Montgomery County, Pennsylvania, require plaintiffs to make their trust submissions prior to trial. Because a plaintiff can delay his or her trust submissions until after solvent defendants are cast in judgment, disclosure requirements prior to trial can be virtually meaningless. *See* Dixon & McGovern, *supra*.

Although many TDPs provide for defendants cast in judgment to seek contribution from a trust, post-judgment contribution rights appear to be illusory at worst and prohibitively difficult at best. Under many TDPs, claims for contribution against settlement trusts are referred to as "indirect claims." For these indirect claims to be presumptively valid, the indirect claimant must prove, among other things, that it has paid in full the liability or obligation of the trust to the claimant and that the claimant has forever and fully released the trust from all liability. These requirements are difficult to meet, given that many claimants who have not resolved their claims with all bankruptcy trusts or who have intentionally delayed the submission of these claims simply refuse to sign the required release. Although an indirect claimant's failure to meet the "presumptively valid" requirement is not necessarily fatal to a contribution claim, most TDPs will not pay contribution claims unless the indirect claimant has in fact paid for liability that was actually adjudicated to the trust. Therefore, unless a judge or jury actually adjudicates fault to the trust for any portion of the plaintiffs' injuries, any claim for contribution would be denied. *See, e.g.*, Owens Corning Trust Distribution Procedures § 5.6; *see also* Shelley, Cohn, & Arnold, *supra*, at 9.

Are These Problems Real?

Although there is little in the way of hard data to substantiate fears of abuses of the bankruptcy trust process, there are indications that the confidentiality and delay provisions in trust TDPs have been used by some to attempt double recovery. For instance, in the case of *Kananian v. Lorillard Tobacco Co.*, No. CV 442750, (Ct. Com. Pl., Cuyahoga Cnty., Ohio (2007 an Ohio trial court exposed alleged "double-dipping" by a plaintiff from tort defendants and the trusts. Harry Kananian, the plaintiff, died of mesothelioma in 2000, and his estate sued Lorillard Tobacco Co., alleging that his mesothelioma was caused by asbestos fibers encapsulated in cigarette filters manufactured by Lorillard. The estate also lodged claims with a number of asbestos settlement trusts, seeking extrajudicial compensation for Kananian's death. Lorillard sought discovery of Kananian's submissions to the trusts to obtain setoffs for any eventual recovery and evidence of alternative exposure. However, behind closed doors, Kananian's attorney encouraged the Celotex Trust to object to Lorillard's discovery requests, while simultaneously telling the court that he would "welcome" disclosures from the trusts. Kananian's counsel further objected to the admissibility of claim forms by questioning their accuracy, despite having submitted the forms himself. Upon discovery of the claim forms, it was revealed that Kananian's lawyers had submitted contradictory information to different trusts in order to maximize recovery. The trusts already had paid the estate as much as $700,000 on the basis of inconsistent claims and product identification. To the court, Kananian's lawyers conceded that the trust forms were inaccurate and misleading. .

The ethically dubious strategy of submitting inconsistent information in court and to the trusts at the expense of solvent defendants was laid bare in the internal memorandum entitled "Preparing for Your Deposition," which was distributed by a prominent asbestos plaintiffs' firm to its clients. This memorandum was reprinted in full in a report on the state of asbestos litigation to the United States Senate. S. Rep. No. 108-118, at 109–31 (2003). The memorandum, which became publically available in 1997, appears to set forth a systematic strategy to maximize recovery against solvent defendants and prevent disclosure of evidence against bankrupt entities. The firm would show clients pictures of products that the firm wanted in the case and record acknowledgments of exposure on "work history sheets," which were provided to defendants in discovery. The memo instructed the plaintiff to testify only to exposures to products on the work history sheet and provided a script for the client's deposition, including 10 pages of product descriptions. The memorandum further instructed the client to avoid identifying the products of bankrupt defendants and defendants not sued in the case: "Do NOT mention product names that are not listed on your Work History Sheets. The defense attorneys will jump at a chance to blame your asbestos exposure on companies that were not sued in your case." Further, "Keep in mind that these [defense] attorneys are very young and WERE NOT PRESENT at the jobsites you worked at. They have NO RECORDS to tell them what products were used on a particular job, even if they act like they do." *See id.*

Attempts to Bring Trusts Back into the Fold

Although no solution is perfect, courts from several jurisdictions have recognized and come up with creative ways to handle the trust problem.

For example, in *Volkswagen of America Inc. v. Superior Court*, 43 Cal. Rptr. 3d 723 (Cal. Ct. App. 1st Dist. 2006), a California appellate court recognized that a plaintiff's refusal to disclose trust submissions in discovery operated to deprive defendants of the information they needed to obtain valid setoffs. In granting discovery on trust submissions, the court held that "each party who shares responsibility for any asbestos-related disease from which a claimant suffers is liable only for its proportionate share of non-economic damages, each will understandably be concerned to determine whether the claimant has overstated its share of responsibility." As discussed above, obtaining the necessary discovery on trust submissions cures only half of the problem. Even when discovery into trust submissions is allowed, many TDPs may still allow a claimant to delay submissions until after trial, effectively concealing potentially responsible parties from defendants until it is too late. In

addition, many TDPs do not require a claimant to submit depositions or discovery from concurrent or previous asbestos exposure litigation. Thus, just as solvent tort defendants are blind to claims made against trusts, the trusts are often blind to sworn testimony denying exposure to a product for which the trust bears liability.

Recognizing these shortcomings, one Washington trial court has allowed a reduction in a plaintiff's recovery for amounts "received to date" from trusts; "agreed to and to be received" from trusts; "that can be obtained by application to existing bankruptcy trusts"; and "that can be obtained from bankruptcy trusts expected to soon become available." In applying the setoff for future recoveries, the court estimated "the amounts that plaintiffs would have received had they diligently applied to bankruptcy trusts, including amounts that Plaintiffs [were] scheduled to obtain in the future should they decide to apply to those bankruptcy trusts." In an opinion, the court chastised the plaintiffs for a lack of "any explanation as to their failure to apply to these trusts" and placed the onus on the plaintiffs to explain their lack of disclosure and diligence. In essence, the court was unwilling to require the defendants to pay a recovery that plaintiffs did (or even could) receive from trusts. In calculating the judgment, recovery from the defendants was reduced based on actual payments already received or agreed upon from settlement trusts, on estimated recoveries from trusts that were not yet operating at the time, and even on estimated recoveries from settlement trusts for which the plaintiffs elected not to apply. *Coulter v. AstenJohnson*, 2008 WL 4103199 (Wash. Super. Ct. May 30, 2008).

In some jurisdictions, judges have entered master case-management orders providing for the timely application and disclosure of asbestos trust submissions prior to trial. For example, in the New York City Asbestos Litigation , the master case-management order provides that plaintiffs are required to disclose trust claims that have been filed and that all trust claims must be filed at least 90 days before trial. Similarly, in West Virginia, Judge Ronald Wilson's case-management order requires that the plaintiff provide a sworn statement to all parties outlining "any and all existing claims" against bankruptcy trusts, as well as those claims that "may exist" against bankruptcy trusts. The statement must also include when the claim was made "or will be made," and must contain an affidavit that the statement is based on a good-faith investigation of all potential claims against asbestos trusts. Although there is no requirement that trust submissions be made prior to trial, penalties for noncompliance with the investigation requirement include striking the case from a trial group. In addition, some Pennsylvania courts have held that non-settling defendants should receive a settlement credit for bankruptcy trust recoveries, including estimated future bankruptcy trust recoveries. *See, e.g.*, *Andaloro v. Armstrong Indus., Inc.*, 799 A.2d 71, 82 (Pa. Super. 2002); *Baker v. ACandS, Inc.*, 729 A.2d 1140, 1146 (Pa. Super. 1999), *aff'd*, 755 A.2d 664 (Pa. 2000).

A Global Solution

Judicial attempts to rein in the asbestos bankruptcy trust system's effect on litigation have proven effective, but a lack of coordination and effective concealment of trust distributions are still widespread outside the few jurisdictions that have implemented proactive case management orders. Although the efforts of these judges are admirable, the national scope of asbestos litigation renders reform in isolated jurisdictions largely futile in the face of a national problem. The judiciary is simply ill-suited to correct a fundamental flaw in applicable law, particularly one that applies throughout the United States. Moreover, when faced with unfavorable laws, standards, or rules, claimants simply move on to greener pastures in other jurisdictions, as shown by the mass exodus of claimants from states such as Mississippi and Texas following asbestos tort reform. Judges are bound to apply the law, and while many have taken steps to minimize adverse impacts, a judge's power is limited to the litigants that find their way into his or her court.

While many defense attorneys have suspicions about motivations in delaying trust submissions until after trial and refusing to disclose settlement documents exchanged with the trusts, it is largely undisputed that these tactics are within the bounds of the law. The failure is not a product of the claimant seeking to recover. Rather, the failure lies with the law that fails to prevent double-dipping. Case-management orders and setoffs, while helpful, treat the symptom and not the cause. As all TDPs are established under the auspices of bankruptcy law, to usher in true reform, Congress must amend the bankruptcy code.

Presently, most TDPs allow claimants to seek distributions from trusts after collecting a recovery in the tort system. As previously discussed, this encourages delaying trust submissions until after judgment, creating the potential for a double recovery. In the tort system, a plaintiff cannot collect twice for the same injury. Long ago, this country made a policy decision that a litigant may bring suit only once against all those responsible, putting to bed the possibility of potentially indefinite liability. An amendment to the bankruptcy code requiring asbestos trusts to demand that claimants submit their claims prior to a tort judgment would extend this policy decision to the asbestos bankruptcy trust system. An added benefit would be certainty and finality in the claims process not only for solvent defendants but for the trusts as well, because a claimant would be required to bring trust claims either before or contemporaneously with a tort suit. Thus, once a litigant obtains judgment in the tort system, the trusts would be relieved of liability as well.

In addition, most TDPs prohibit the trust from disclosing the identities of claimants, even to defendants sued in the tort system by the same claimant, without a subpoena. Although the subpoena requirement is not onerous per se, the sheer number of section 524 trusts requires defendants to blindly issue subpoenas for records to any and all trusts to which a plaintiff may have potentially submitted a claim, searching for the proverbial needle in a haystack. Considering that asbestos trusts have been established in jurisdictions from Pennsylvania to Texas, requesting

subpoenas to be issued to multiple trusts in several jurisdictions likely outside the subpoena power of the court makes the prospect all the more difficult. Rather than place the burden on the defendant seeking the existence of trust claims, the burden should be on the plaintiff to disclose those trusts to which he or she submitted a claim.

Again, an amendment to the trust code is the only global solution. Section 524 already requires certain mandatory provisions in TDPs, and a provision requiring claimants to disclose to defendants the fact that they submitted a claim to the trust is neither onerous nor unfair. Such a provision would still require defendants to subpoena records, but it would eliminate the unnecessary guesswork presently involved in obtaining claims forms. This would also continue to protect the identity of claimants from uninterested parties, while allowing defendants entitled to the information to obtain it efficiently.

Although such amendments would undoubtedly result in a reduction in the average amount an asbestos claimant can recover from the tort system and the bankruptcy trust system, these amendments would balance the equities of the current system in which claimants hold all the cards. Defendants would be put on notice of potential exculpatory evidence prior to judgment and be given the means to obtain it. All that is asked in return is that plaintiffs timely make trust submissions and disclose their submissions to the defendants they have sued.

Conclusion

Asbestos litigation has always been a special breed of products liability that never quite fit into the traditional constructs of the tort system. The existence of—and problems with—asbestos personal injury trusts are no exception. The trust "problem" isn't going away, and regardless of the liability regime or how the various jurisdictions deal with accounting for trust compensation, the paradigm shift from the tort system to the bifurcated system is complete. Although many courts have recognized the problem and some have come up with solutions, litigants must continue to develop proactive, unique, and creative strategies to account fairly for payments asbestos claimants receive from the trusts. However, true reform will require an amendment to the U.S. bankruptcy code preventing TDPs from distributing funds to claimants that have already collected in the tort system and requiring plaintiffs to fully disclose prior distributions to those defendants facing asbestos claims.

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