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Cos. Can Sell Future Asbestos Liabilities To Avoid Bankruptcy

By **Milan Ceppi and Charles Oswald** (August 10, 2020, 5:30 PM EDT)

In today's world, filing for Chapter 11 bankruptcy protection under Section 524(g) of the Bankruptcy Code has become common for asbestos claims defendants. Over 100 companies have filed for bankruptcy protection due, in part, to asbestos personal injury claims, and over 39 companies have filed since 2010.

Most recently, on June 18, two units of Trane Technologies PLC, an affiliate of Ingersoll-Rand Co., filed a Chapter 11 case in North Carolina bankruptcy court. This marks the third time this year that a unit of a large corporation has filed a Section 524(g) asbestos bankruptcy case.[1]

On the surface, a bankruptcy under Section 524(g) appears to offer several advantages — including, notably, finality with respect to future obligations related to paying and defending asbestos claims. This bankruptcy model has been followed since the Johns-Manville Corp. bankruptcy, a non-Section 524(g) reorganization that was novel in establishing a claims injunction that channeled future asbestos claims to a settlement trust funded by the debtor. [2]

This mechanism, codified into the Bankruptcy Code in 1994 as Section 524(g), allows companies to reemerge from the bankruptcy process free and clear of asbestos claims — some of which can manifest years or decades into the future due to the latent nature of asbestos-related diseases. The process, however, is not without its pitfalls.

While bankruptcy does help entities achieve true finality from their asbestos-related and other contingent liabilities, it often requires a long, complex process, at a very high cost that is largely out of a company's control. Once an entity has filed for bankruptcy protection under Section 524(g), it requires the coordination of the court and legal representatives for both current and future asbestos claimants, and may present potential insurance issues to overcome.

Bankruptcy proceedings under Section 524(g) are often complex and time-consuming, as debtors and parent companies engage in negotiations with personal injury plaintiff creditor committees, legal representatives and, in some instances, insurance carriers. Ultimately, the process diverts time and resources that could otherwise be used to focus on core operating business. On average, a bankruptcy case under Section 524(g) takes approximately four years to complete from petition to plan confirmation, and several cases have lasted over a decade.

Due to the 75% supermajority vote requirement under Section 524(g), plaintiff committee creditors have the power to block any plan of reorganization that is presented in court[3]. This often leads to protracted pre-Chapter 11 filing negotiations with creditors in order to get a plan of reorganization approved and passed. In addition, the cost of bankruptcy counsel, where rates can range from \$1,000 to \$5,000 per hour, can be prohibitive, and can severely erode the value of filing for bankruptcy.



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This was no more evident than in the bankruptcy case of Garlock Sealing Technologies LLC, which is largely heralded as a landmark case in the world of Section 524(g) asbestos bankruptcies.[4] Garlock, a former asbestos defendant in the tort system, was able to confirm a plan that many believed cost Garlock less than its total estimated liability.

However, upon closer examination of Garlock's prebankruptcy financials and the assets and fees involved in its bankruptcy case, Garlock actually spent significantly more in bankruptcy to globally resolve its asbestos liability than the company's estimated asbestos liability prior to its bankruptcy filing. In a March 2010 10-K filing with the U.S. Securities and Exchange Commission, just three months prior to its bankruptcy filing, Garlock booked a reserve of \$485 million for its current and future asbestos liability.[5]

In comparison, Garlock's eight-year bankruptcy reorganization cost the debtor a staggering \$146.8 million in professional fees, which included \$71.6 million for the debtor's own law firms and experts. When this was added to the \$478.8 million in debtor funding to the settlement trust for present and future claimants, Garlock's total bill exceeded \$625 million.[6]

A view of the most recent pending cases shows the same dynamic playing out, with large professional fees accruing even before the bankruptcy discovery process begins. For a debtor to enter into the Section 524(g) asbestos bankruptcy process, it must acknowledge and price in the costs of what has become a cottage industry of law firms, experts and other professionals who bill their time against the debtor's estate.

These costs are on top of the risk a company takes when it enters into bankruptcy in terms of the estimation of current and future asbestos claims. For instance, in the example of the Garlock bankruptcy, the plaintiff committee's expert in the case filed an estimation report claiming that Garlock's asbestos liability was more than \$1.3 billion — over a billion dollars more than what's Garlock's own expert estimated the company's liability to be.[7]

The Garlock case is not unique. The estimation of liabilities by plaintiff committee experts and future claims representative experts are often multiples of what a company may be booking in its SEC disclosures prior to bankruptcy, or what its own experts estimate the liabilities to be in bankruptcy.

In Owens Corning's Section 524(g) bankruptcy case, for example, the plaintiffs expert claimed that Owens Corning would have to fund a trust with more than \$11 billion to satisfy its current and future asbestos obligations.[8] This was more than five times higher than the estimation put forth by an expert representing the bank creditors' interests, more than \$4 billion more than the estimate of Owens Corning's own experts, and approximately \$3 billion more than the estimate of the expert for the representative for future claimants.[9]

Ultimately, the court accepted an estimation of \$7 billion to fund the resultant Section 524(g) trust — a figure that was \$5.5 billion more than what Owens Corning had booked in its SEC disclosures in the year prior to its bankruptcy.[10]

Fortunately for asbestos defendants, a more cost-effective and less complicated nonbankruptcy solution exists, through the sale of a legacy entity holding contingent liabilities to a third party. Through a structured sale of a legacy entity, a third-party buyer can fully manage all future liability, and offer the same finality that Section 524(g) provides to asbestos defendants.

A true arms-length transaction with a third party that specializes in purchasing contingent liabilities is an efficient, economically sensible alternative to ensure protection against any future claims. In this type of transaction, the seller is no longer responsible for the liabilities of the entity that has been sold. The actual structure of the transaction is determined on a case-by-case basis, depending on the corporate structure of the seller.

Contingent liabilities are often isolated in a legacy subsidiary, or can be transferred into an entity to be bought by a third party. Once the transaction is complete, the seller's legal connection to the contingent liabilities is transferred to the third-party buyer, and the seller is free from legal risk related to asbestos or other mass torts.

Unlike insurance or other run-off solutions, a true sale of a corporate entity holding contingent

liabilities to a third party completely removes the seller's contingent liabilities from its balance sheet. This is particularly important given that asbestos defendants are often undervalued due to the overhang of their liabilities.

The sale and removal of such liabilities should result in higher valuations for mergers, acquisitions and other strategic opportunities, along with better opportunities for coverage and terms from banks and Wall Street. This, paired with substantial reductions in future defense costs from carrying the contingent liabilities, should significantly improve the balance sheet of the seller.

In addition to improved financial prospects, a sale to a third party will grant the seller operational finality from the sold entity and its contingent liabilities. The seller will no longer have to defend itself against the legacy claims, or pay for any future settlements. This will allow the seller to reduce claims management and legal defense resources, giving the seller the opportunity to focus on core businesses rather than mitigating litigation risk.

Selling an unwanted subsidiary with contingent liabilities to a third party is a lower-cost solution when compared to a Section 524(g) bankruptcy and most other insurance options. The parties have the power to control the transaction timeline, meaning that the seller has greater control over when it will be free of its liability, and is not dependent on a decision by a court.

Any asbestos defendant who is considering a Section 524(g) bankruptcy, or otherwise looking to be permanently freed from their contingent liabilities, may want to consider a structured sale to a third-party buyer for a more cost-effective and efficient way of achieving a full and final resolution of contingent legacy liabilities.

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[1] In re Aldrich Pump LLC et al., No. 20-30608, W.D. N.C., Bkcy.; In re Murray Boiler LLC, No. 20-30609, W.D. N.C. Bkcy.; In re DBMP LLC, No. 20-30080, W.D. N.C., Bkcy.; In re Paddock Enterprises LLC, No. 20-10028, D. Del. Bkcy.

[2] In Re Johns-Manville Corp. et al., Nos. 82-B-11656-11676, S.D. N.Y, Bkcy.

[3] Brown, S. Todd, Section 524(g) Without Compromise: Voting Rights and the Asbestos Bankruptcy Paradox (Sept. 1, 2008). 2008 COLUM. BUS. L. REV. 841. Available at SSRN: <https://ssrn.com/abstract=1115190>.

[4] In Re Garlock Sealing Technologies LLC et al., No. 10-31607, W.D. N.C., Bkcy.

[5] Enpro Industries Inc., U.S. Securities & Exchange Commission, Form 10-K – March 3, 2010 <https://www.sec.gov/Archives/edgar/data/1164863/000095012310020653/g22340e10vk.htm>.

[6] In Re Garlock Sealing Technologies LLC et al., No. 10-31607, W.D. N.C., Bkcy., Amended Consolidated Chapter 11 Final Report and Accounting, March 28, 2018.

[7] <https://legalnewsline.com/stories/510515899-claimants-expert-in-garlock-trial-suggests-1-3-billion-settlement-figure>.

[8] In re Owens Corning et al., No. 00-3837, D. Del., Bkcy.

[9] https://www.crowell.com/documents/DOCASSOCFKTYPE_ARTICLES_377.pdf;
<https://www.asbestos.com/blog/2013/01/29/estimating-asbestos-claims-bankruptcies/>.

[10] <https://www.sec.gov/Archives/edgar/data/75234/000007523400000003/0000075234-00-000003.txt>.

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