HISTORICAL TORT SYSTEM CLAIM VALUES CANNOT BE REDUCED BY "NUISANCE" SETTLEMENTS AND "IMPLICIT DEFENSE COSTS" TO DETERMINE PRESENT AND FUTURE ASBESTOS LIABILITY IN §524(G) BANKRUPTCIES

Bankruptcy Judge in Specialty Products Holding Corp. (a/k/a RPM, Inc.) and Bondex Int'l Cases Determines Present Value of the Debtors' Asbestos Liability at $1.2 Billion Rejecting Debtors' "Novel" Estimation of $300 - $575 Million[1] [2]

In the bankruptcies of Specialty Products Holding Corp. (a/k/a RPM, Inc.) and Bondex International, Inc. (collectively, the "Debtors"), Judge Judith Fitzgerald of the U.S. Bankruptcy Court in Wilmington, Delaware rejected the Debtors' "novel" claim estimation approach that reduced from the Debtors' settlement history the settlement of "nuisance" claims and "implicit defense costs" for the purpose of determining present and future asbestos liability.[3]

Debtors and related non-debtors with derivative liability may receive permanent injunctive relief from asbestos liability through a channeling injunction and creation of a trust to pay present and future asbestos claims pursuant to the provisions of Section 524(g) of the Bankruptcy Code.[4] Estimation proceedings typically determine the value of the asbestos claims based on historical claim rates and values against the debtors in the tort system.[5]

Debtors' expert, Dr. Charles H. Mullin, sought to minimize the Debtors' asbestos liability by dividing Debtors' historical settlement payments into two components: (1) indemnity compensation for damages and (2) "implicit defense costs" (*i.e.*, the amount Debtors were willing to pay to avoid legal fees).[6] As Dr. Mullin explained, individually evaluated claims paid $45,000 on average and cost an additional $45,000 for defense costs.[7] In contrast, group settlements that were not subject to the same individualized review paid $63,000 on average but cost only $5,000 in transaction costs.[8] As the increased settlement amounts reflected an effort to avoid legal fees "outside of the damages or liability they faced," Debtors theorized that the "implicit defense costs" should be deducted from the settlement history to estimate Debtors' present and future asbestos liability.[9] Taking an additional step, Dr. Mullin concluded that mesothelioma settlements entered into for $50,000 or less were "nuisance" settlements to save defense costs and did not demonstrate liability, and assigned such nuisance claims a zero-value for claims estimation modeling purposes.[10] To support Dr. Mullin's analysis, Debtors relied upon insurance coverage litigation theory and a decision in Owens Corning where portions of settlements attributed to punitive damages were removed from the claim estimation analysis.[11]

In rejecting the Debtors' expert's analysis, the Court followed the rule in Owens Corning that "claims must be 'appraised on the basis of what would have been a fair resolution of the claims in the absence of bankruptcy' and the value and validity of claims are determined under state law."[12] Assuming, *arguendo*, the proposition that Debtors settled cases, in part, to avoid legal fees, the Court refused to accept Debtors' position that their historical payments should be

reduced by implicit defense costs, and dismissed the notion that tort claimants would have accepted $20,000 less on average per settlement.[13] Settlements are "not unilateral deals" and represent "a value on the claim that *both parties accept*."[14] This is reflected in the standard dueling statements in settlement agreements that "the settlement is neither proof of liability for the underlying conduct that led to the claim nor [does] it represent[] all damages to which plaintiff is entitled."[15] As the Court's "task is to estimate what amount will compensate present and future victims exposed to Debtors' products, the value both sides (Debtors and tort victims) historically chose is clearly relevant."[16] The Court further rejected Debtors' contention that the group settlements did not indicate liability because the merits of those claims were not examined, instead finding that Debtors demanded proof of exposure to their products in many of the settlements.[17]

Likewise, the Court disagreed with Debtors' position that mesothelioma claims paid $50,000 or less should be valued at zero as representative of defense costs savings not "liability" of the Debtors.[18] The Court reasoned that even minimal settlements "are relevant to estimation because they place a value on the claims" and indicated at least some evidence of exposure to a Debtors' product or Debtors' decision not to contest exposure.[19] This value is the "best evidence" of Debtors' "legal liability" which would otherwise be determined by a jury or Debtors' agreement in settlement.[20] The Court further found that Debtors' past settlement history was inconsistent with their present denial of "any liability" for present or future asbestos personal injury claims.[21] [22]

As a result, the Court discredited Dr. Mullin's testimony in the case and rejected Debtors' efforts to minimize the present value of Debtors' asbestos exposure to $300 - $575 million, and estimated the present value of Debtors' liabilities for mesothelioma claims at $1.1 billion, in the range of estimates of the Future Claims Representative expert Erin Green and the Asbestos Creditors' Committee expert Dr. Mark Peterson, plus an additional 6% or $66 million for non-mesothelioma claims per agreement of the parties.[23] Non-debtor parent RPM International Inc. ("International") immediately issued a press release stating its intent to appeal and that the decision substantially overstated their liability.[24]

This decision, if not overturned, will stand as a substantial obstacle for debtors seeking to minimize the amount of their asbestos liability in the face of a long settlement history on grounds that amounts paid represent "nuisance" claims and "implicit defense costs" not liability. This is particularly significant for non-debtor companies with derivative asbestos exposure such as International. The protection of a Bankruptcy Code § 524(g) channeling injunction will only be available if "fair and equitable" with respect to the non-debtor, weighing the benefit of the injunctive relief and the non-debtor's contribution to the asbestos trust.[25] Under this decision, International will be required to provide a substantially greater contribution than it intended to meet the requirements of § 524(g) to permanently channel its derivative asbestos exposure.

[1] Timothy J. Durken is a bankruptcy and litigation attorney at Jager Smith P.C. and may be reached at tdurken@jagersmith.com. He was a member of the trial team for an ad hoc committee of asbestos tort victims that successfully defeated Pfizer, Inc.'s ("Pfizer") and Quigley Company, Inc's ("Quigley") plan of reorganization seeking a permanent channeling injunction under Bankruptcy Code § 524(g) to relieve the defunct Quigley and its parent Pfizer of billions of dollars of asbestos liability. In rejecting the plan, the Court held that (i) the plan was not proposed in good faith, (ii) the channeling injunction was not "fair and equitable" under Bankruptcy Code § 524(g) because Pfizer's contribution was less than 25% of the benefit Pfizer would receive by channeling its derivative asbestos exposure, (iii) the plan was not feasible because Quigley was not viable beyond Pfizer's agreed period of support; (iv) recoveries failed to meet the "best interest of creditors" test because tort victims would receive less under the plan than the value of their claims against Pfizer that would be retained in a liquidation; and (v) the same distribution to prepetition settling claimants and non-settling claimants under the plan constituted "unequal treatment" because non-settling claimants were giving up additional claims against Pfizer; and the Court designated the vote of the prepetition settling claimants who were incentivized to vote to receive their second-half payment under the prepetition settlement agreements and not their treatment under the plan. See generally In re Quigley Company, Inc., 437 B.R. 102 (Bankr. S.D.N.Y. 2010).

[2] This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to the author.

[3] See Memorandum Opinion re: Estimation of Debtors' Asbestos Liability, In re Specialty Products Holding Corp. a/k/a RPM, Inc., Case No. 10-11780 (JKF) (Bankr. D. Del.), entered on May 20, 2013 [Dkt. No. 3852] (the "Memorandum Decision"), p. 3. Section 502(c)(1) of the Bankruptcy Code requires the Bankruptcy Court to estimate for the purposes of allowance "any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case." 11 U.S.C. § 502(c)(1).

[4] See generally 11 U.S.C. § 524(g) (setting forth numerous requirements before such relief may be granted).

[5] Memorandum Decision, at p. 1 (citing Owens Corning v. Credit Suisse First Boston, 322 B.R. 719, 721-22 (D. Del. 2005)).

[6] Id. at p. 37.

[7] Id. at p. 41.

[8] Id.

[9] Id. at p. 37.

[10] Id. at p. 42.

[11] Id. at pp. 38, 42 (citing Owen Corning, 322 B.R. at 722).

[12] Id. at p. 43 (citing Owen Corning, 322 B.R. at 722).

[13] Id. at p. 38.

[14] Id. (emphasis added).

[15] Id.

[16] Id.

[17] Id. at p. 43.

[18] Id. at p. 31.

[19] Id. at p. 26.

[20] Id.

[21] Id. The Court rejected Debtors' effort to minimize their liability by arguing that their products contained chrysotile asbestos which is less potent than other types of asbestos. Id. at pp. 9-16. The Court concluded that "based on the[] studies and the current state of scientific research in the area, chrysotile has not been ruled out as a cause of mesothelioma, even if the chrysotile is uncontaminated or minimally contaminated with an amphibole asbestos." Id. at p. 16. The Court also rejected Debtors' effort to minimize their liability based on a purported "de minimis" market share. Id. at pp. 16-20. The Court found "that Debtors' market share argument has not been accepted as evidence in the tort system" and "did not govern Debtors' settlement decision[s]." Id. at p. 17. The fact that 40 million people were potentially exposed to Debtors' products, the high volume of airborne dust, and the increasing evidence of chrysotile-induced asbestos disease led the Court "to conclude that Debtors will face claims and future demands in large numbers and will be liable." Id. at p. 20.

[22] The Court also found that Dr. Mullin's forecast was inaccurate because he applied individually evaluated dismissal rates of 25 to 30 percent to group settlements despite the fact that *all claims* were paid in many of the group settlements as new claims with proof of exposure were substituted for discarded claims which did not satisfy the exposure requirement. Id. at 40, 43. The Court rejected other aspects of Dr. Mullin's analysis including (i) that changes in Texas law from joint and several liability to only several liability resulted in two to four-fold impact on settlement amounts because it ignored other parts of Texas law including grandfather rules; (ii) inclusion in his analysis of the amount of Debtors' settlement payments to fit within their annual budget which "was not based on their total expected costs nor was it aligned with the value of claims already pending" and backlogged; (iii) Debtors' attempt to compartmentalize claims based on exposure to specific eras in their history and the apportionment of liability among the companies because exposures crossed eras and the Debtors "always got releases for the entire family of companies, regardless of which was sued" and never "raised separate or individualized defenses in the tort system"; and (iv) to seek to apportion liability among companies through a choice of law analysis that even if it had some merit would have a de minimis effect on the claims estimation. Id. at pp. 44-47.

The Court also considered the fact that the third-party consulting firm hired by the Debtors' parent to estimate their asbestos liability to fund reserves, Crawford & Winiarski, employed a methodology similar to the experts for the Future Claims Representative and Asbestos Creditors' Committee, which "bear[ed] little resemblance to Dr. Mullin's" analysis, and considered "the historical rate at which the Debtors paid mesothelioma claims, the Debtors' historical settlement averages, and the Debtors' historical defense costs and the relationship of indemnity payments thereto." Id. at pp. 21-22. Also relevant to discrediting Dr. Mullin's analysis, the Court recognized that Debtors' parent paid $162 million in the two years prepetition and Debtors paid $200 million in the four years prepetition "nearly equal[ing] the entire sum Dr. Mullin estimated as necessary to satisfy all of the Debtors' present and future liability to asbestos victims." Id. at pp. 22-23.

[23] Id. at 1-2, 20, 47, 49-50.

[24] See RPM Press Release, dated May 20, 2013 at http://ir.rpminc.com/phoenix.zhtml?c=75922&p=irol-newsArticle&ID=1822305&highlight=.

[25] Section 524(g) requires that "identifying such debtor or debtors, or such third party …, in such [channeling] injunction with respect to such demands … is fair and equitable with respect to the persons that might subsequently assert such demands, in light of the benefits provided, or to be provided, to such trust on behalf of such debtor or debtors or such third party." 11 U.S.C. § 524(g)(4)(B)(ii); see e.g., In re Quigley Company, Inc., 437 B.R. at 133 (Bankr. S.D.N.Y. 2010) (holding that the "fair and equitable" prong requires "that there must be a relationship between the benefits received and the contributions made by the third-party that receives the benefit of the injunction" at least where the trust does not propose to pay 100%).