The Features and Limitations of Asbestos Settlement Trusts: A Primer

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Introduction

Section 524 of title 11 of the United States Code (“Bankruptcy Code”) prevents creditors from recovering pre-bankruptcy debts after plan approval if their recovery was not already provided for in the approved bankruptcy plan. 1 Subsection (g) of section 524 provides a special procedure for debtors previously engaged in the sale or production of asbestos-containing products to restructure while ensuring those injured through exposure to those products are compensated. 2 In particular, section 524(g) provides for the formation of a trust that can settle asbestos related tort claims after the plan has been confirmed by a bankruptcy court. 3 These trusts are funded in whole or in part by the securities of the debtor, which is required to make future payments to the trusts. 4 In return, the debtor receives an injunction barring direct claims against it for asbestos related injuries.

This memorandum serves as a primer on asbestos settlement trusts created under section 524(g) of the Bankruptcy Code. Part I provides a historical background on these trusts and the reasons for their conception, focusing on the Johns-Manville bankruptcy case. Part II provides an

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2 11 U.S.C.§ 524(g).
3 See id.; see also 140 Cong. Rec. S14464 (statement of Sen. Hatch).
overview of the most notable features and elements of these trusts and provides case examples for each core element. Part III provides specific case examples of debtors attempting to subvert the normal bankruptcy process by limiting or broadening the scope of certain elements.

Discussion

I. How the Manville Trust Created the Framework for 11 U.S.C. Section 524(g) and Allowed for Compensation by Future Claimants

A. Background and the Problem of Future Claimants.

Asbestos is a mineral that was commonly used in consumer and industrial products during the first half of the twentieth century. In the early 1970’s asbestos exposure was linked to lung disease and various bodily cancers including mesothelioma. These diseases are categorized by an unusually long latency period following exposure; but the earliest asbestos exposure victims, once diagnosed, sued the producing companies en masse. The bankruptcy case of the largest asbestos manufacturer, Johns-Manville Corp. (“Manville”), set the stage for what would become an entire industry of litigation.

Manville became subject to a litany of tort litigation by those suffering from asbestos-related disease and devised a framework to compensate those exposed to asbestos long into the future while keeping itself in business by filing for relief under Chapter 11 of the Bankruptcy Code in 1982. Manville’s bankruptcy was prompted not by a then present inability to pay debts, but by anticipation of massive personal injury liability. Manville, its creditors and shareholders, representatives of asbestos victims, insurance companies, and other interested parties devised a way to both restructure the company and ensure that future asbestos claimants would receive

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6 See Kane v. Johns-Manville Corp. 843 F.2d 636, 639 (2d Cir. 1988).
9 Kane, 843 F.2d at 639.
some compensation for their injuries. Given the latency of asbestos-related disease, a core
distinction between Manville’s (and indeed all asbestos manufacturers) bankruptcy and other
restructuring was the existence of unknown creditors who held claims against the company but
would not know of their injuries until well into the future. The bankruptcy court in the Manville
case appointed a legal guardian for future claimants to represent their interests them in plan
negotiations.

B. The Solution – The Trust and Channeling Injunction Model

After years of negotiations, Manville proposed a Chapter 11 plan that was ultimately
confirmed by the bankruptcy court. The United States Court of Appeals for the Second Circuit
affirmed the court’s order confirming the plan in 1988. Pursuant to the plan, the “Asbestos
Health Trust” was formed. Under the plan, the trust was funded by insurance settlements, cash,
and Manville’s future profits. The trust’s sole responsibility was to attempt to settle, or if
necessary, litigate over claims brought by asbestos victims and their families. By funding the
trust with proceeds from the company which could then operate without the specter of litigation,
the debtor could in turn use its profits to fund the trust. Additionally, claims of present
claimants were settled upon plan approval under the same guidelines that the trust would operate
under, meaning that pre-trust creation creditors and post-trust claimants would be treated the
same. In exchange for setting up and funding the trust, Manville and its insurers were granted a
“channeling injunction” that prevented tort claimants from suing them for asbestos exposure and

   between “known” and “unknown” creditors).
12 Kane, 843 F.2d at 639.
13 Id. at 634.
14 Id. at 640.
15 See id.
16 Id.
17 See id. at 640–41.
redirected all asbestos related claims to the trust. The trust is still operational and paying claims today.\textsuperscript{18}

In 1994, Congress codified the Manville plan as the framework for all future asbestos bankruptcies via the enactment of section 524(g) of the Bankruptcy Code.\textsuperscript{19} The most notable provisions of the statute are discussed in greater detail below.

\section*{II. The Features and Elements of an Asbestos Settlement Trust and Requirements for an Injunction}

Section 524(g)(2)(B) of the Bankruptcy Code prescribes the conditions that must be met by a debtor prior to the granting of the channeling injunction which saddles asbestos liabilities on a trust.\textsuperscript{20} Specifically, an asbestos trust must: (i) assume the liabilities of the debtor; (ii) be funded in whole or in part by the securities of one or more debtor or the debtor’s promise to make future payments; (iii) have a majority of voting shares or an option to acquire a majority of voting shares of the debtor; and (iv) be continuously funded by assets of the debtor.\textsuperscript{21} Further external conditions which must be met are: (i) substantial demand for future payment arising out of asbestos exposure; (ii) uncertainty of amount and timing of future demands; (iii) detriment to other claimants if relief is sought from the debtor directly; (iv) approval of the plan by currently-known asbestos claimants by a 75\% margin; and (v) set standard procedures for plan compensation to ensure similar claims are paid in a similar manner.\textsuperscript{22} Only after all these criteria are met can a channeling injunction be issued by a bankruptcy court to divert asbestos claims to a trust under section 524(g).

\textsuperscript{19} See 140 CONG. REC. S14464 (statement of Sen. Brown); 11 U.S.C. § 524(g).
\textsuperscript{21} Id.
\textsuperscript{22} 11 U.S.C. § 524(g)(1)(B)(ii).
A. The Trust

Trusts organized under section 524(g) must assume both the liabilities and assets of the debtor. The liabilities must include claims against the debtor for its involvement in the “personal injury, wrongful death, or property-damage action seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos-containing products.” Trust assets consist of securities or other consideration provided by the debtor such as a promise to contribute to the trust. In order to insure that claimants are treated fairly and are paid similarly to each other for similar injuries, procedures for managing claims are approved by the bankruptcy court as part of the final plan.

B. The Channeling Injunction and the Scope of its Protections - Section 524(g)(1)(B)

Section 524(g)(1)(A) allows a bankruptcy court to issue an injunction releasing the debtor from asbestos-based liabilities. “Channeling asbestos-related claims to a personal injury trust relieves the debtor of the uncertainty of future asbestos liabilities. This helps achieve the purpose of Chapter 11 by facilitating the reorganization and rehabilitation of the debtor as an economically viable entity.” This type of injunction works similarly to those issued by bankruptcy courts in other types of restructuring cases, with the exception being that they have force not only on prepetition claims, but post-petition claims as well. Such injunctions have the force to “enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand

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24 Id.
25 Id.; see Kane v. Johns-Manville Corp., 843 F.2d 636 (2d Cir. 1988).
that, under a plan of reorganization, is to be paid in whole or in part by [the] trust” that is set up in the reorganization process.\textsuperscript{30}

The channeling injunction’s reach can be broad, as it serves to protect not only the debtor, but any party with a financial interest or other relation to the debtor.\textsuperscript{31} However, such protection may only be limited to derivative claims from asbestos production and manufacture, depending on the circuit.\textsuperscript{32}

\textit{C. Funded by the Debtor Company – Section 524(g)(2)(B)(i)}

In order to receive the powerful equitable tool of the channeling injunction, the trust born from the discharge must be “funded in whole or in part by the securities of 1 or more debtors involved in such plan or [their] obligation . . . to make future payments . . . .”\textsuperscript{33} Additionally, the trust either must own or be entitled to own through certain conditions a majority voting share of the debtor.\textsuperscript{34}

In practice, plans have shown a great deal of flexibility on these elements. For example, in \textit{In re Plant Insulation Co.}, the Ninth Circuit held that a trust could be given an option to purchase equity in the debtor rather than be given it where the trust received a great deal of its funding from the debtor’s insurer.\textsuperscript{35} In that case, the trust purchased 40% of the reorganized debtor’s shares for market value but held a warrant to purchase a further 11% at its discretion for a mere $1.\textsuperscript{36} The court in that case held that despite having purchased the first 40% of shares, the

\begin{itemize}
\item \textsuperscript{30}11 U.S.C. § 524(g)(1)(B).
\item \textsuperscript{31}See \textit{In re Celotex Corp.}, 204 B.R. 586 (Bankr. M.D. Fla. 1996); \textit{In re W.R. Grace & Co.}, 13 F.4th 279 (3d Cir. 2021) (insurers of the debtor receiving protection).
\item \textsuperscript{32}See \textit{In re Combustion Engineering, Inc.}, 391 F.3d at 234 (finding such claims must be derivative); \textit{In re W.R. Grace & Co.}, 900 F.3d 126, 136–37 (3d Cir. 2018) (finding that derivative liability protection applies to both direct and third-party actions).
\item \textsuperscript{33}11 U.S.C. § 524(g)(1)(B)(i)(I).
\item \textsuperscript{34}11 U.S.C. § 524(g)(1)(B)(i)(II).
\item \textsuperscript{35}734 F.3d 900, 906 (9th Cir. 2013).
\item \textsuperscript{36}Id.
\end{itemize}
warrant served to satisfy the section 524(g)(1)(B)(i)(II) requirement.\textsuperscript{37} As in the archetypical \textit{Manville} case, most asbestos settlement trusts are funded in large part by insurers of the debtor, who also receive the benefit of the channeling injunction.\textsuperscript{38} In addition to insurance and securities, debtors may at least partially fund trusts through the issuance of promissory notes to be paid by the company over a number of years.\textsuperscript{39}

\textbf{D. Establishment of a Class of Current Claimants who Must Approve the Plan by a 75\% Vote – Section 524(g)(2)(B)(ii)}

Section 524(g)(2)(B)(ii)(IV)(BB) of the Bankruptcy Code requires that the final reorganization plan providing for the trust must be approved by 75\% of claimants who are situated like those who would file claims with the trust.\textsuperscript{40} This provision preserves the due process rights of future claimants who would not otherwise have the opportunity to advocate for themselves during the bankruptcy proceedings.\textsuperscript{41} In non-asbestos restructuring cases, debtors must give “such notice as is appropriate, including notice to any holder of a community claim, of an order for relief in a case under this title.”\textsuperscript{42} The requirement of approval by asbestos exposure victims serves as a substitute for Bankruptcy Code section 342’s notice requirement for the undiscovered creditor-claimants who the debtors are typically unaware of.\textsuperscript{43}

\begin{itemize}
\item \textsuperscript{37} \textit{Id.}
\item \textsuperscript{38} See \textit{In re W.R. Grace & Co.}, 13 F.4th 279 (3d Cir. 2021).
\item \textsuperscript{39} See \textit{In re W. Asbestos Co.}, 313 B.R. 832, 851 (Bankr. N.D. Cal. 2003).
\item \textsuperscript{40} 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(BB).
\item \textsuperscript{41} \textit{In re Flintkote Co.}, 526 B.R. 515, 523 n. 10 (D. Del. 2014).
\item \textsuperscript{42} 11 U.S.C. § 342(a).
\item \textsuperscript{43} 11 U.S.C. § 342.
\end{itemize}
III. Limiting and Broadening the Scope of Asbestos Settlement Trusts

A. Trust Distribution Procedures May Limit the Scope of Potential Claims

Section 524(g)(2)(B)(ii)(III) of the Bankruptcy Code conditions approval of a debtor’s bankruptcy plan upon a determination that a failure to follow those procedures would threaten the plan’s purpose.44 Trust procedures determine exactly how an asbestos settlement trust fulfills its purpose, which is paying out claims equally for each claimant for as long as claims are filed.45 A trust’s procedures may provide, for example, a) how asbestos claimants submitted claims to the trust, b) the Trust’s evaluation of claims based on set criteria, including by an individual review process, if necessary, and c) a calculation and payout of a set percentage of a claim’s assigned value.46 These standardized procedures exist to “avoid time-consuming state court discovery” by slotting claimants into various categories of asbestos-related disease that had assigned to them base damage amounts, modified further by the claimant’s age, family size, and economic impacts.47

Despite typically being meticulously designed, asbestos trust settlement procedures are sometimes unable to pay out certain asbestos-related claims. For example, in In re Darden, the family of decedent asbestos exposure victim sued for compensation for their state-based wrongful death claim arising from Darden’s asbestos-related death, and the Bankruptcy Court for the Northern District of California found that the trust would be unable to compensate them.48 This is because in California, a wrongful death action arises from a family’s pecuniary

46 Id.
47 Id. at *5.
48 Id. at *10.
loss of their relative and is distinct from the death of that relative. As such, any claim in California based on wrongful death would be unpayable by the trust. This serves as a reminder that claims which fall outside of the set procedures for an asbestos trust are generally non-compensable.

B. The “Texas Two-Step”

Some former asbestos corporations have attempted to take advantage of the channeling injunction while limiting their involvement in supporting the requisite settlement trust as required by statute. A new corporate restricting method serves as an avenue for asbestos debtors to disperse their obligations and responsibilities inherent in the statutory scheme of section 524(g) as applied to them.

In the case of In re DBMP LLC, CertainTeed Corporation, a manufacturer with significant asbestos liabilities, restructured itself to load its asbestos liabilities onto a shell company before that company’s filing for bankruptcy. In short, the North Carolina corporation CertainTeed converted into a Texas LLC, then performed a divisional merger into two Texas LLCs (one holding the Asbestos liabilities), and then converted the non-liability laden company back to the State of North Carolina, this time as an LLC. To meet section 524(g)’s funding requirements, the new CertainTeed LLC promised to fund the debtor and the trust it would create. Ultimately, the bankruptcy court was dubious of this scheme and found that the merger which had created two distinct companies had a negative effect on the asbestos creditors’ ability

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50 See id. at *10.
53 Id. at *11.
54 Id. at *12.
to recover on their claims and permitted claimants and creditors to attack it for its inequity.\textsuperscript{55} Creditors dubbed this divisional merger strategy the “Texas Two Step.”\textsuperscript{56} While the plan of CertainTeed’s lawyers to keep the operating company out of bankruptcy has yet to fully come to fruition, they may succeed yet.\textsuperscript{57}

In the \textit{In re Bestwall LLC} case, the court found that a bankruptcy case pursuant to the same Texas Two Step model employed by CertainTeed could not be dismissed for been having brought in bad faith.\textsuperscript{58} Additionally, the court found that the operating company emerging from the divisional merger may be granted all the same protections of the debtor under the Bankruptcy Code’s automatic stay provision, 11 U.S.C. \textsection 362.\textsuperscript{59} A third case where the Texas Two Step was employed saw representatives of asbestos victims treat the scheme differently. In \textit{In re Aldrich Pump LLC}, asbestos-victim creditors did not object to the debtor’s employment of the scheme and saw it as the “most expeditious and just way for the Debtors to ensure that holders of current and future asbestos claims are compensated fully and fairly.”\textsuperscript{60} While this method may seem to subvert the debtor’s connection to the trust as contemplated in section 524(g), it has not been outright shunned by creditors.\textsuperscript{61}

\textbf{Conclusion}

The bankruptcy process for debtors with asbestos-related liabilities, as prescribed by section 524(g) of the Bankruptcy Code, have distinct differences from an ordinary chapter 11 corporate restructuring. This is due to the long latency period of asbestos-related disease. In the

\textsuperscript{55} \textit{Id.} at *26.
\textsuperscript{56} \textit{Id.} at *22.
\textsuperscript{57} \textit{See In re Bestwall LLC}, 606 B.R. 243 (Bankr. W.D.N.C. 2019), \textit{aff’d}, No. 3:20-CV-105-RJC, 2022 WL 68763 (W.D.N.C. Jan. 6, 2022) (finding that a debtor who performed the “two step” could have the ability to sufficiently fund such a trust as required by statute).
\textsuperscript{58} \textit{In re Bestwall LLC}, 605 B.R. at 49–50.
\textsuperscript{59} \textit{See In re Bestwall LLC}, 2022 WL 68763 at *2.
\textsuperscript{60} \textit{In re Aldrich Pump LLC}, No. 20-30608 (JCW), 2021 WL 3729335, at *22 (Bankr. W.D.N.C. Aug. 23, 2021).
\textsuperscript{61} \textit{Id.}
nearly 30 years since section 524(g)’s enactment, debtors have devised methods to utilize the bankruptcy process not contemplated at the statute’s inception, sidestepping key burdens and requirements placed on debtors.