

Prepackaged bankruptcies: resolving overwhelming mass tort liabilities using the Bankruptcy Code

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Chapter 11 of the Bankruptcy Code provides companies with an effective and efficient means to resolve otherwise overwhelming mass tort liabilities. Although the Chapter 11 model has been applied most often to companies faced with asbestos liability, it has also been used to resolve liabilities for mass torts associated with silica dust, medical device failures, and trichloroethylene groundwater contamination. The recent cases of Halliburton and Combustion Engineering provide useful guidance on the effective application of the Chapter 11 model to mass tort claims.

In a little over one year, Halliburton completed a prepackaged bankruptcy of its Mid-Valley and Dresser subsidiaries. The stock market responded favorably to the resolution of Halliburton's asbestos liability by causing Halliburton's stock price to nearly double. Halliburton achieved this result by using section 524(g) of the Bankruptcy Code, a provision that Congress added to the Bankruptcy Code specifically to accommodate the reorganisation of companies facing liability for personal injuries resulting from exposure to asbestos. Halliburton created a section 524(g) trust and funded it with cash and securities worth more than \$5bn. By following the requirements of section 524(g), Halliburton obtained an injunction channeling both existing and future asbestos liability from Halliburton and its subsidiaries to the section 524(g) trust and simultaneously created significant value for its stockholders.

Recent developments in the Combustion Engineering ("CE") bankruptcy case form a stark contrast to the successful outcome in Halliburton. The Third Circuit Court of Appeals has reversed the lower court's confirmation of the asbestos-related prepackaged plan of CE, which is the US subsidiary of the Swiss engineering company ABB Group. Several issues distinguish Halliburton's bankruptcy from CE's. This article focuses on three of them – each meriting the attention of any company considering the use of a prepackaged bankruptcy to resolve mass tort liability.

First, the future claimants' representative was engaged much earlier in the Halliburton bankruptcy process than in the CE bankruptcy process. Because of his early involvement, Halliburton's future claimants' representative was unrestricted in his ability to negotiate funding for the future claims, a circumstance that made it easier for the court to conclude that the plan was fair.

Second, Halliburton did not make advance payments to existing claimants as part of its preparation for bankruptcy. Rather, prior to filing its bankruptcy case, Halliburton negotiated settlements with many of its existing claimants that liquidated the amounts of their claims. The settled claims were not paid pre-bankruptcy but instead were left subject to plan confirmation and payment from the post-reorganisation section 524(g) trust. Because all payments, even those going to the settled claimants, were contingent upon plan confirmation, all of the claimants

voting on Halliburton's plan had full incentive to participate in the bankruptcy process. In contrast, CE used a pre-bankruptcy trust to partially fund settlement payments to a group of existing claimants. And CE then relied on the remaining, unpaid portion of the existing claims, the so-called "stub claims," to achieve a favourable 75 percent vote, which is required of asbestos claimants pursuant to section 524(g) to confirm a plan of reorganisation.

Third, by making all payments to asbestos claimants subject to plan confirmation, and by funding them exclusively through a section 524(g) trust, Halliburton avoided the certain prospect of a diminished recovery for any non-settling existing claimants and for future claimants. The end result for Halliburton was a transparent bankruptcy process in which all parties maintained a meaningful role throughout the reorganisation.

Adequate representation of future claimants

The need for representation to protect the interests of the future claimants in the context of mass tort bankruptcies is well established. Because of the latent nature of asbestos and many other mass tort injuries, the future claimants, having no knowledge of their injuries or potential claims, are unable to protect their interests during bankruptcy proceedings. Once a debtor is protected by a section 524(g) channelling injunction, future claimants are unable to pursue the ▶▶

assets of the debtor and, potentially, its insurers and affiliates. The future claimants' interests are also in tension with those of the existing claimants; the more the existing claimants are able to recover, the less that will be available for the future claimants.

In Combustion Engineering, the Third Circuit viewed with disfavour the late engagement of a future claimants' representative. By virtue of the transfer of nearly half of CE's assets to a pre-bankruptcy settlement trust, the pool of assets from which to fund a section 524(g) trust was greatly diminished by the time CE engaged the future claimants' representative. As a result, holders of certain claims enjoyed a higher percentage recovery on their claims than did future claimants.

The Combustion Engineering decision makes clear that future claimants must be represented throughout the process leading up to the filing of a prepackaged bankruptcy. By engaging the future claimants' representative early in the process, Halliburton gave future claimants real negotiating leverage. The future claimants' representative was able to negotiate trust funding levels based on Halliburton's historic liability to asbestos claims instead of being forced to accept

whatever assets remained after payments were set aside for existing claimants.

Artificial impairment of the existing asbestos claimants

The Third Circuit was also concerned that CE's reliance on stub claims in the plan voting process constituted impermissible "artificial impairment." For a plan to be confirmed, a court must find that at least one impaired class has accepted the plan. Artificial impairment occurs when a "plan imposes an insignificant or de minimis impairment on a class of claims to qualify those claims as impaired under § 1124." Avoiding artificial impairment is a particular challenge in the asbestos context section 524(g) requires that a plan be approved by a supermajority of holders of impaired asbestos claims. In Combustion Engineering, the Third Circuit noted that "an estimated 99,000 of the approximately 115,000 'valid' confirmation votes appear to have been stub claim votes" and questioned whether votes cast by stub claim holders, who had already received most of the value of their claims from the pre-bankruptcy trust, provided the "indicia of support by affected creditors" required for plan confirmation.

Halliburton, on the other hand, was not faced with the allegation of artificial impairment. Like CE, Halliburton settled with many of the existing claimants before the filing of its bankruptcy case, thus liquidating the value of their claims. The key difference between the two cases is that Halliburton did not fund payments to any claimants in advance of their voting on the plan. Thus, all claimants voting on Halliburton's plan of reorganisation had the full value of their claim at stake in the bankruptcy proceeding.

Inequality of treatment of substantially similar claims

The Third Circuit also questioned whether CE's plan satisfied the Bankruptcy Code's requirements that a plan of reorganisation provide "the same treatment for each claim or interest of a particular class" and provide that "present claims and future demands that involve similar claims" are to be

paid "in substantially the same manner." In Combustion Engineering, the settling existing claimants were to receive on average 59 percent of the value of their claims, counting payments from both the pre-bankruptcy trust and the section 524(g) trust, while the non-settling existing claimants and the future claimants, paid from only the section 524(g) trust, were likely to receive only 18 percent of the value of their claims.

In contrast to the CE plan, Halliburton's plan process did not favour the settling claimants. Under Halliburton's plan, all claimants, whether their claims were liquidated by pre-bankruptcy settlements or the trust's valuation procedures, were to be paid exclusively out of the section 524(g) trust at the same percentage on their allowed claims. Additionally, because Halliburton did not pay claimants in advance of the bankruptcy, it preserved for the court the ability to view "as an integrated whole" the payments to be made to the settling claimants, non-settling claimants, and future claimants.

Conclusion

By engaging a future claimants' representative early in its plan process, Halliburton ensured that the future claimants' due process rights were fully protected. By avoiding pre-bankruptcy payments, Halliburton ensured that all affected creditors had a meaningful economic stake in the proceedings, thus forestalling any allegation of artificial impairment. By making the payments to the settling claimants subject to plan confirmation and by processing all claims through the section 524(g) trust, Halliburton ensured similar treatment among asbestos claimants. In summary, the "Halliburton plan . . . could provide a template for the 524(g) resolution of most of the asbestos bankruptcy cases." ■

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This article was written with the assistance of Travis N. Turner, a student at Washington & Lee University Law School.

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