

Asbestos

The Bankruptcy Wave Of 2000 — Companies Sunk By An Ocean Of Recruited Asbestos Claims

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Commentary

The Bankruptcy Wave Of 2000 — Companies Sunk By An Ocean Of Recruited Asbestos Claims

By Charles Bates
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[Editor's note: Charles Bates is the president and senior partner at Bates White, where Charlie Mullin is a partner. Replies to this commentary are welcome.]

Introduction

Mass recruited claims caused the bankruptcy wave of asbestos defendants that began in 2000 and eventually resulted in the bankruptcy of more than 40 companies. Prior to 2000, more than half of all asbestos-related expenditures were for mass recruited non-malignant claims. Today, we know that these recruited claims were based on questionable medical diagnoses, many of which were out-right fraudulent.

The revelation of these fraudulent diagnoses, coupled with key changes in the tort environment, has led to the cessation of mass recruitment. As we will explain below, these mass recruited claims may eventually cost defendants, their insurers, and seriously injured asbestos claimants \$50 billion. Though beyond the scope of this paper, it is also clear that owners of the equity and debt of the asbestos defendants that went bankrupt since 2000 have also lost billions of dollars.

Today, non-malignant claims have decreased to about 10 percent of asbestos-related expenditures and continue to decline. Had the present tort environment existed for the prior two decades, the bankruptcy wave of asbestos defendants that started with Babcock & Wilcox in February of 2000 would not have occurred. Most of these now bankrupt defendants would still be solvent today and into the future, continuing to pay meritorious cancer and impaired non-malignant claimants.

Mass Recruited Claims Of The 1990s

The asbestos litigation environment of today is dramatically different than it was only a few years ago. Figure 1 displays the rapid decline in the number of non-malignant personal-injury claims filed in the United States.

Whereas non-malignant claims were being generated at a rate of 55,000* per year in 2000 and 2001, that number was about 1,700 in 2005 — three percent of the 2000 and 2001 rate. This decline in non-malignant claims is directly attributable to the cessation of mass recruitment of unimpaired non-malignant claims; it is not due to a general decline in all asbestos-related claims. During this same time period, the number of mesothelioma claims has remained relatively constant. Also, there was no corresponding decrease in the number of severely impaired non-malignant claims. The number of these claims is small, averaging less than 100 per year since 1990, and steadily declining. Their numbers did not markedly decline, however, with the collapse in the number of unimpaired non-malignant claims.

Notably, as figure 2 shows, non-mesothelial cancer claims have decreased along with the non-malignant claims. We estimate that between 55 and 70 percent of lung and other cancer claims arose from the same mass recruitment activities that produced the vast majority of non-malignant claims. About half of these other cancer claims come directly out of recruitment events. Another 10 percent to 25 percent are “come-back claims” — claimants originally recruited as non-malignant claims who subsequently develop cancer.

A few states exemplify the change in the litigation environment. Mississippi courts received about 40,000 claims with “diagnoses” between 1999 and 2001. These claims represent nearly a quarter of all non-malignant claims created in these years, while Mississippi contains about one percent of the United States population. The claimants in these cases reside in over 40 states. Notwithstanding their geographic dispersion, these claimants were largely represented by a handful of law firms and were “diagnosed” by a few doctors. In contrast, Mississippi courts have received fewer than 100 Mississippi non-malignant claims diagnosed in 2004.

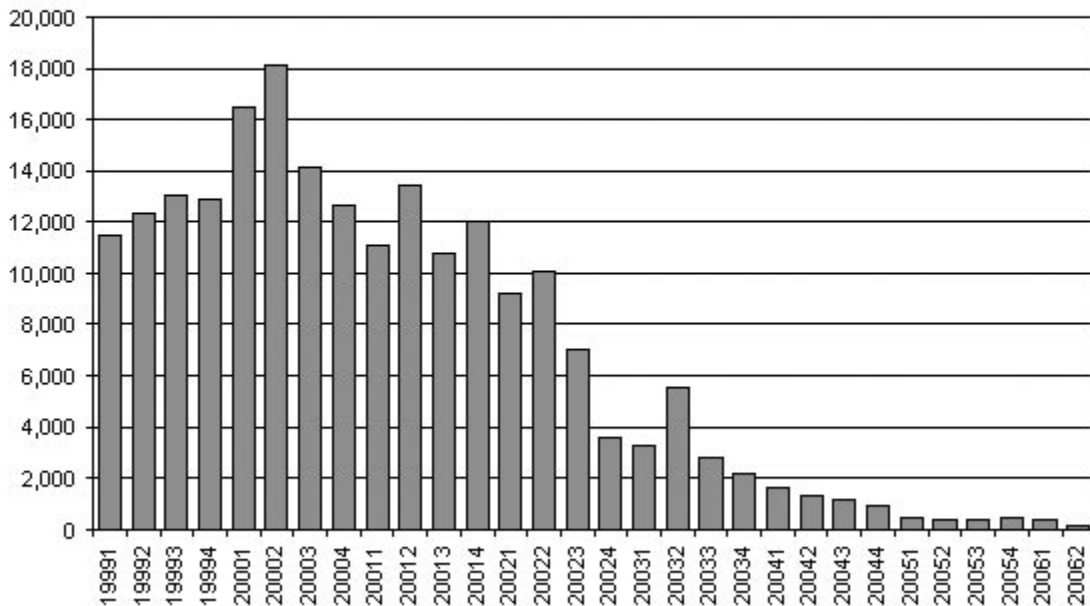
Texas, the state with the most non-malignant claims through time, displays a similar pattern. Law firms have filed nearly 115,000 non-malignant claims in Texas. Nearly 60 percent of these claims came from five law firms and the vast majority has the same group of “diagnosing” doctors as the bulk of the Mississippi non-malignant claims. As figure 3 shows, filings in Texas have fallen from a high of nearly 14,000 claims per year in 2001 to 1,000 claims in 2004 and 250 in 2005.

Two key factors caused the dramatic decline in recruited asbestos claims. First, states that were the source of the vast majority of these lawsuits changed their tort laws or civil procedures. These changes include requiring plaintiffs to demonstrate actual impairment before they are assigned a court date, ensuring that each claim stand on its own merits (eliminating mass consolidations), and enforcing venue restrictions.

Second, the fraudulent nature of these recruited asbestos claims was publicly revealed. The culminating event was U.S. District Court Judge Janis Graham Jack’s conclusion that the mass recruitment of non-malignant claims was “driven neither by health nor justice ... they were manufactured for money.”¹ Subsequent to Judge Jack’s statements, the Manville Trust and other 524(g) asbestos personal-injury trusts disallowed claims with diagnoses from the suspect doctors. More importantly, judges throughout the country have become critical of medical evidence and now allow defendants to challenge that evidence more readily.

Non-malignant claims submitted to the Manville Trust by quarter of diagnosis

figure 1



The dramatic impact of these changes shows how tenuous the vast majority of these claims were. Many were out-right fraud. Others only had value when presented in mass numbers such that the cost to defend significantly outweighed the cost to settle. Once these claims were required to stand on their individual merits and demonstrate not just the potential of exposure, but actual physical impairment with a real diagnosis from a treating physician, these non-malignant claims evaporated.

Expenditures by defendants and their insurers for over 650,000 non-malignant claims have been enormous, about \$20 billion by 2000. That cost is over half the money spent on asbestos personal injury claims spanning three decades. Over 80 companies that paid this expense have gone bankrupt. Further, numerous insurance companies also have become insolvent. Did mass recruitment cause these bankruptcies?

More generally, suppose claims had been required to demonstrate valid impairment on a case-by-case basis from the beginning. How different would the asbes-

tos tort history have been? A comprehensive analysis of this question is beyond the scope of this paper. Instead we focus on a narrower question. Did the mass recruitment of non-malignant claims cause the 2000 to 2002 bankruptcy wave?

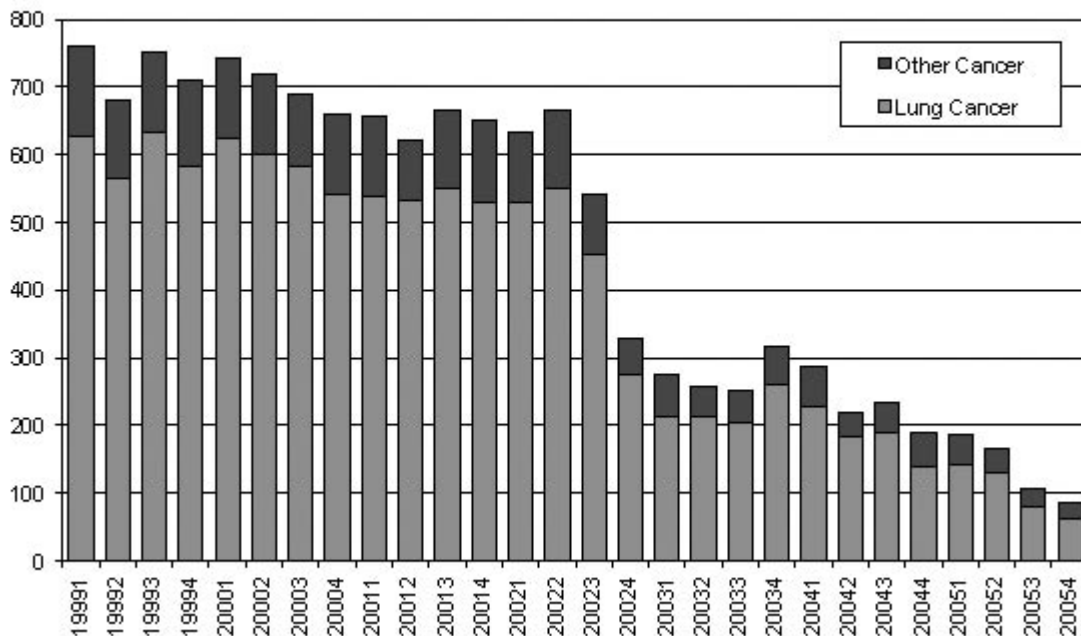
The Bankruptcy Wave Of 2000 To 2002

Prior to its bankruptcy in February 2000, Babcock & Wilcox (B&W) had received over 320,000 non-malignant claims, which were 93 percent of its asbestos personal-injury claims. It cost B&W over \$1 billion to resolve these non-malignant claims, over two thirds of the money it spent to settle asbestos claims. This expenditure exhausted its insurance in 1999, directly leading to its bankruptcy in early 2000. In less than two months, another company with over \$1 billion in asbestos expenditures, Pittsburgh Corning, filed for bankruptcy protection.

Later that year, the solvent company with the largest share of asbestos-related expenditures, Owens Corning Fiberglass (OCF), also exhausted its insurance coverage and filed for bankruptcy protection. Two

Cancer claims submitted to the Manville Trust by quarter of diagnosis

figure 2



years before, OCF had given up its long-standing defense posture of litigating many claims and instead had instituted the National Settlement Program (NSP). NSP was designed to settle nearly all of its outstanding and future claims at established values. Prior to the NSP, OCF had spent over \$2.3 billion to resolve asbestos claims, half of which went to pay non-malignant claims. By the time of its bankruptcy in October 2000, OCF had settled 350,000 claims for \$4 billion. Of this, 88 percent of claims and \$2 billion were for non-malignant conditions.

With claims against three of the largest asbestos payers stayed by their bankruptcy filings, demands by asbestos plaintiffs against the remaining solvent defendants skyrocketed. Armstrong, GAF, W. R. Grace, USG, and FMO quickly ran through all of their available insurance and each filed for bankruptcy protection in rapid succession over the next ten months. By the end of 2001, 17 asbestos defendants had gone bankrupt. In the following few years, over 25 additional asbestos defendants filed bankruptcy as the settlements of

each rose rapidly due to the departure of the largest asbestos claim payers.

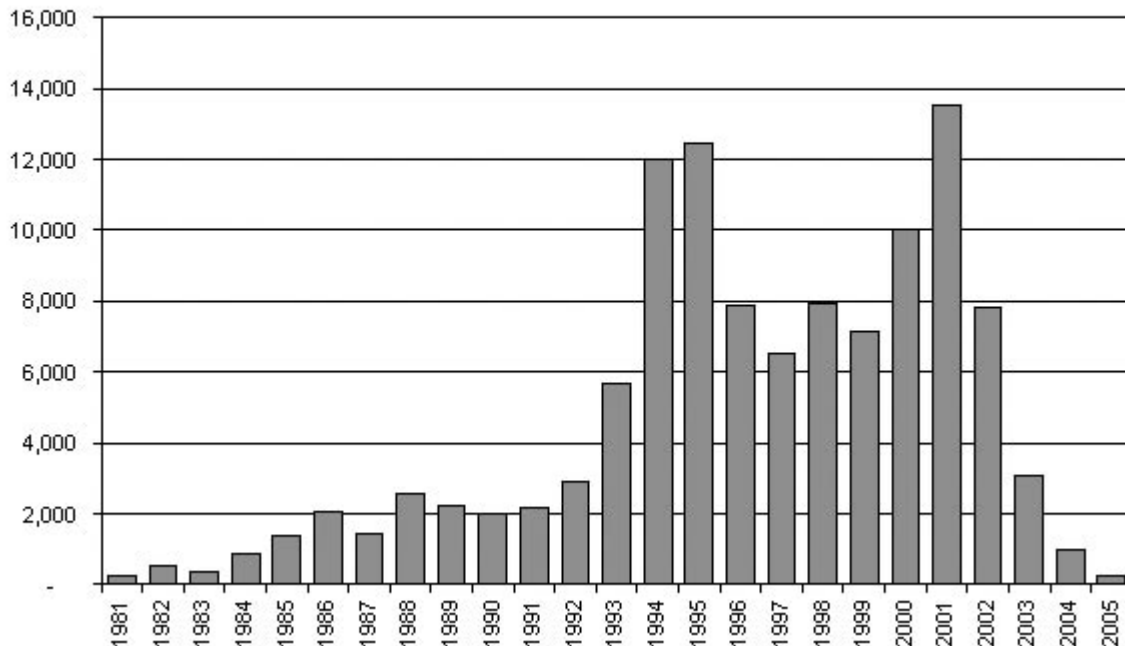
Mass Recruited Claims Caused The 2000 To 2002 Bankruptcy Wave

We performed three analyses to determine that mass recruited claims caused the 2000 to 2002 bankruptcy wave. First, we estimated what the asbestos-related expenditures would have been for each of the now bankrupt defendants excluding an appropriate portion of the mass recruited claims. Second, we calculated how each company's insurance would have eroded over time with the recast asbestos expenditures. Finally, we reconstructed each company's financial statements with the recast asbestos expenditures to determine whether each could have remained solvent.

Less than 10 percent, and more likely less than five percent of the historical non-malignant claims would have been filed if the current tort environment had prevailed over the last two decades. Mass recruitment of claims would not have been profitable under the

Non-malignant Texas claims submitted to the Manville Trust by year diagnosed

figure 3



current tort environment, and hence would not have occurred. Instead, non-malignant claims would have arisen from the same mechanisms that generate mesothelioma claims — an individual gets sick, receives a diagnosis from a treating physician, and is referred to a lawyer.

This conclusion is supported by comparisons of claiming rates in states with different tort environments, the claiming rates of the more serious non-malignant disease categories, the results of the Manville claim audit in the mid-1990s, and other claim review studies. At this lower claiming rate, the Manville Trust would have received between 35,000 and 65,000 non-malignant claims instead of the 670,000 that it did receive.

In addition to fewer non-malignant claims, there also would have been fewer lung and other cancer claims as well. We estimate that between 55 and 70 percent of lung and other cancer claims arose from the same mass recruitment activities that produced the vast majority of non-malignant claims. About half of these cancer claims come directly out of recruitment events. Another 10 percent to 25 percent are “come-back claims” — claimants originally recruited as non-malignant claims who subsequently develop cancer. By themselves, lung and other cancer claims can be expensive to prosecute and are too rare to justify the mass recruiting expense. Thus, in an environment in which non-malignant recruitment is no longer profitable, the majority of these lung and other cancer claims are not filed.

In total, we estimate that the seven companies we analyzed, (B&W, OCF, AWI, GAF, W. R. Grace, USG, & FMO), would have paid about \$5 billion less in settlements from 1990 to 2000 but for the mass recruitment of asbestos claims. Extrapolating to all defendants, this indicates that unimpaired and fraudulent asbestos claims directly cost defendants and their insurers about \$15 billion from 1990 to 2000.

To estimate the impact of this extra expense on the financial performance of the defendants, our next step was to analyze what fraction of these expenses defendants' insurers paid and how it affected their remaining insurance coverage. The first step was to estimate the amount of insurance available to these defendants and what fraction of their asbestos indemnity and expense

payments insurers would reimburse. The companies we analyzed have publicly disclosed their remaining products limits at various times in the past. Some of these companies have also asserted additional “non-products” or other insurance coverage prior to, or at the time of, their bankruptcy filing. Although this additional coverage is in dispute, we now know that some of these companies have settled with their insurers for more than their product liability limits. For simplicity, however, we analyzed the companies using only their disclosed products insurance limits. We did not attempt to account for the outcome of insurance coverage disputes that may be resolved in the future or that have been resolved since the bankruptcy filings.

Four of the companies we analyzed would still have several hundred million in insurance product liability limits remaining in 2010, the end of the analysis period. In total they would have over \$1.3 billion in limits remaining in 2010. Two others would exhaust their product limits in 2010. The remaining one would exhaust its products limits in 2008.

The final analysis was to recast the public financial statements of the defendants using their recast asbestos expenditures and insurance recoveries. For six of the seven companies it was clear that none of these companies would have filed for bankruptcy protection in 2000, 2001 or any other year into the foreseeable future. The last company, FMO, would have survived at least until 2010, and possibly into the foreseeable future. The only question is whether its operating income could sustain both its debt load and its asbestos liabilities once its insurance was exhausted. Currently its operating margins are at their lowest in years, most likely exacerbated by the distraction and strain on the company from its very complicated bankruptcy proceedings. However, if the low margins were actually the result of a permanent change in its business environment, then its debt load would be a problem if it also had to carry all of its asbestos expenditure after its insurance had run out.

Conclusion

The bankruptcy wave of asbestos defendants that began in 2000 was caused by the recruitment of over 600,000 unimpaired individuals to asbestos personal injury lawsuits. These lawsuits would not have been filed if the current tort environment prevailed throughout the last two decades.

The cost of these lawsuits was much more than the \$15 billion in direct costs to defendants and insurers to resolve these cases. The Chapter 11 reorganization expenses of the companies forced into bankruptcy since 2000 will easily exceed \$2 billion. Further, the Manville and other existing asbestos Trusts, e.g. Celotex Trust and APMC, had their funds depleted to such an extent that the seriously injured asbestos claimants only received a small percentage of the payment they would have otherwise received. For example, the Manville Trust would have had \$1.7 billion more to pay seriously injured claimants but for the mass recruited claimants. Its payment percentage would have been about 25 percent of liquidated claim values, instead of the five percent it currently pays. That is, mesothelioma claimants who have received \$20,000 or less from the Manville Trust could have received \$80,000 for their claim.

There is another very large cost resulting from the mass of unimpaired claimants. While the large asbestos defendants forced into bankruptcy by these claimants are reorganizing and establishing trusts to pay their asbestos liability, solvent defendants are paying for the current asbestos liability of the reorganizing defendants. This transfer of liability resulting from the legal principle of joint and several liability greatly increases the litigation risk to a solvent defendant whose codefendants are protected from personal injury lawsuits while being reorganized. Even though the litigation environment has changed, so that mass recruiting of unimpaired claimants is no longer a viable business, the cost of the remaining serious asbestos claims has increased dramatically for the solvent defendants from the bankruptcy of their codefendants who previously paid the largest share of the asbestos liability.

The ultimate cost of this liability transfer is still to be determined. It depends on whether solvent defendants can transfer the liability back to their codefendants from which it came. Since 2000, solvent

defendants have paid billions of dollars that would otherwise have been paid by their codefendants. The future liability of these reorganized codefendants will be paid by trusts established for this purpose. As we discussed in our recent paper "Having Your Tort and Eating It Too?,"* these trusts will have at least \$30 billion to pay asbestos claimants. This is approximately the value of future asbestos liability for all claimants. Suppose plaintiffs are able to first collect the full tort value of their claim from solvent defendants and then collect again from the newly established trust. If so, there will be an additional \$30 billion paid by solvent defendants and their insurers that would not have been paid but for the bankruptcies caused by the mass recruiting of unimpaired claimants.

Combining the estimates above shows that the cost to defendants, their insurers, and seriously injured asbestos claimants from the mass recruiting of over 600,000 unimpaired asbestos claimants may eventually total \$50 billion. In addition, though we have not estimated the actual total, it is clear that owners of the equity and debt of the asbestos defendants that went bankrupt since 2000 have also lost billions of dollars. Thus, the total cost of the ocean of recruited, non-malignant claims is even larger than the \$50 billion we document here.

Endnotes

* All claim counts presented here regarding the Manville Trust are for United States claimants only. Foreign claims have been excluded.

1. In Re: Silica Products Liability Litigation, MDL, Docket No. 1553 (S.D. Tex., June 30, 2005).

* Mealey's Asbestos Bankruptcy Report, Vol. 6, #4 November 2006. ■

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