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Asbestos Trusts May Leave Insurers Out In Cold

By **Shane Dilworth**

Law360 (August 26, 2022, 3:20 PM EDT) -- Legislation allowing companies facing massive asbestos liabilities to create a settlement trust during bankruptcy to compensate people injured after exposure to the substance provided much-needed relief for policyholders, but legal experts say insurers are skeptical of where they fit into the agreements.

Insurance assets can be a significant factor in a trust's proceeds, experts say, but carriers may challenge whether they should pay claims into a trust. In an effort to avert coverage, carriers may also contend that they issued policies to the debtor company rather than a trust.

Furthermore, insurers are also wary of the negotiations that lead to the formation of settlement agreements in this context, especially if they are not involved during the process, experts say. This feeling can be exacerbated by reservations about established procedure for distributing payments from the trust to claimants.

This is the second part in a series exploring the intersection of bankruptcy and insurance issues. The series' first installment discussed how bankruptcy can complicate insurance coverage issues.

Push for Resolving Asbestos Claims

Congress enacted Section 524(g) of the U.S. Bankruptcy Code, also known as the Manville Amendment, in 1994 to allow companies facing enormous amounts of asbestos liabilities to create trusts during bankruptcy to compensate current and future claimants.

The amendment allows for the formation and adoption of a reorganization plan, provided it is accepted by 75% of present claimants as well as a representative for future claimants.

Paul Zevnik of Morgan Lewis & Bockius LLP told Law360 that prior to the enactment of Section 524(g), asbestos bankruptcies were hotly contested. Since the enactment, however, he pointed out that nearly half of such bankruptcies that are successful are prepackaged agreements, or "prepacks."

"There has certainly been a movement since then towards trying to get all constituencies to the table and get a plan resolved before spending the staggering amounts of money that are necessary in order to adjudicate a contested bankruptcy and contested insurance coverage situation," he said.

The current trend in bankruptcy litigation is for judges to approve negotiated bankruptcy plans,

including 524(g) trusts, with little to no objection, Travis Knobbe of Freeman Mathis & Gary LLP told Law360. This results in a dearth of new case law on key issues related to the breadth and scope of those trusts and the circumstances under which they are appropriate, Knobbe said.

He explained that over the past decade, bankruptcy courts have summarily approved channeling trusts similar to those contemplated by 524(g) even if the code does not expressly allow it. As a result, creditors have been discouraged from appealing since the decisions "just get rubber-stamped," he said.

"So case law questioning the appropriate bounds of vehicles that model themselves after the 524(g) trusts over the last decade has become a little more sparse," said Knobbe, who represents carriers.

Insurers' Causes for Concern

Scott Seaman of Hinshaw & Culbertson LLP, who represents insurers, pointed out, however, that prepacks and settlement negotiations during bankruptcy flip the script on how the debtor liability is typically resolved.

During normal litigation, insurers and policyholders typically cooperate to resolve a company's liability. Conversely, in bankruptcy proceedings, the debtor-policyholder and asbestos claimants work together to reach a resolution.

"This distorts things against insurers, particularly where insurance proceeds are a significant part of funding the plan," Seaman said.

The absence of a carrier's input during the settlement process can lead to problems, he went on to say.

"Just as the history of asbestos litigation has been riddled with abuses in the tort system, there have been numerous abuses associated with prepack bankruptcies and 524(g) trusts," Seaman said.

He explained that the first Johns-Manville trust, which was established in 1988, ultimately failed because provisions were not made to preserve funds for future claims. Claimants rushed to submit their claims to the trust after it was formed and depleted the nearly $2 billion in available proceeds by 1992.

The enactment of Section 524(g), however, requires the bankruptcy court to ensure that the trust will be in position to pay similar present claims and future demands in substantially the same manner.

"Unfortunately, many believe 524(g) has been turned into a superhighway for proliferating the abuses associated with asbestos tort claims," said Seaman.

Those abuses, Seaman elaborated, include claimants withholding or disappearing evidence of exposure to defunct asbestos defendants until recovery is obtained from viable defendants. In addition, plaintiffs' lawyers have instructed clients on how to testify, delayed filing of trust claims to keep information from asbestos defendants in the tort system, inflated recoveries, and engaged in other conduct designed to bilk asbestos defendants and insurance companies.

"With the inmates running the asylum, insurers have an interest in ensuring that the [trust distribution procedures] are satisfactory," he said.

He explained that when a trust is being formed, it will include various provisions, including trust

distribution procedures, or TDPs, that address the proofs required to sustain a claim, the classification of claims, a matrix of claim values, dispute resolution procedures and other guidelines relating to the evaluation and payment of asbestos claims.

Seaman explained that where the plan is neutral on insurance issues and the TDPs are acceptable, insurers may sign on to obtain the benefit of channeling injunctions and broad releases.

"Channeling Injunctions" Are Beneficial

A bankruptcy court's approval for the formation of a settlement trust can offer benefits to settling insurance companies, Robert Horkovich of Anderson Kill PC told Law360.

"If an insurance company settles with the policyholder debtor, claims committee and the future claimants' representative, it can get protection by being designated as a protected party, and get the benefit of a federal court channeling injunction," he said.

Horkovich, who represents policyholders, explained that the injunction requires claimants to seek compensation directly from the trust rather than from the debtor company.

Decades of Future Claims

Horkovich went on to say that there is no end in the near future for asbestos injury claims. He pointed to several studies that forecast the filing of injury claims from exposure cases for at least another 20 years.

"Asbestos has not been outlawed, and it hasn't been completely removed," Horkovich said. "So there's still the possibility of exposure."

Additionally, second-hand injury cases brought by the spouses or partners and family members of individuals who had asbestos on work garments that entered the household are expected until 2050.

Horkovich said it might take individuals 20 years to develop an asbestos-related disease if they had second-hand exposure to the fibers.

"There's still a lot of insurance coverage out there," he concluded.

--Editing by Tim Ruel and Khalid Adad.
