K&L ALERT

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Highlights of Proposed Asbestos Legislation

Businesses that have been besieged with asbestos-bodily injury litigation – and those wondering if they could be the next unlikely target in view of the plaintiffs' bar's search for additional pockets – will no doubt be monitoring with interest the progress of Senate Bill 1125, the "Fairness in Asbestos Injury Resolution Act of 2003" ("FAIR Act"). The FAIR Act, introduced by Senator Hatch and six other Senators on May 22, 2003, would bring an end to the decades-old asbestos litigation problem, a problem that of late has seen courthouses clogged with frivolous cases, has driven scores of companies into bankruptcy, has cost industry and insurers billions of dollars, and has enriched plaintiffs' firms, all while truly injured victims are often lost in the shuffle.

At the heart of the FAIR Act would be the creation of a trust to compensate injured asbestos victims, which would be funded, in part, by a multi-billion dollar assessment on businesses that have incurred expenditures related to asbestos claims in the past. (The insurance industry would provide funding equal to that provided by businesses, and existing asbestos trusts would provide funding as well.) Under the terms of the proposed FAIR Act, companies would be relieved from asbestos-related personal injury suits, but will still have to navigate a complex regulatory framework that will determine the appropriate amount of each individual company's contribution to a national settlement fund.

Even if never enacted, the introduction of the FAIR Act will have an immediate and potentially significant impact on businesses facing asbestos claims and insurance disputes in connection with such claims. Companies will have to decide how steps they take (or fail to take) today may be affected by the passage of the Act at some future date. For example:

- Should a company enter into what appears to be a favorable settlement with asbestos claimants or forego a possible settlement in the hope that the claims will be barred after the FAIR Act is passed?
- Should a company pursue buyout or coverage in place settlements from its insurers with respect to underlying asbestos claims? A buyout settlement may present the policyholder with the opportunity of a "windfall" if the FAIR Act is passed into law, but such a settlement – particularly if at a discount – may not appear wise in hindsight if the FAIR Act is not passed.
- Should a company in bankruptcy vigorously pursue a plan of reorganization? The FAIR Act would supersede any such plans that have not been confirmed prior to the date of its enactment. Given the relatively low assessments on some debtors under the FAIR Act, a company in bankruptcy may decide that the FAIR Act offers it more favorable treatment than a plan currently under consideration.

The answer to these and other questions will depend both upon a company's assessment of the likelihood of passage of the FAIR Act, which is far from certain,[1] its assessment of whether the currently proposed funding levels may be increased before the FAIR Act may be enacted, and its analysis of the FAIR Act's intricate provisions. To assist with the latter endeavor, the principal provisions of the FAIR Act addressing the proposed funding and effect of the FAIR Act's trust fund arrangement are summarized below.

EFFECT ON PENDING CLAIMS AND AGREEMENTS

The Act would give industry immediate relief from pending and future personal injury asbestos claims.[2] Claims pending in either state or federal court as of the date of enactment of the Act would be dismissed and the claimant would have two years to file a claim with the proposed Federal Court of Asbestos Claims ("Asbestos Court") based in the District of Columbia.[3] The Asbestos Court would also have exclusive jurisdiction over any future personal injury claims arising out of the health effects of exposure to asbestos. Moreover, the Act supersedes and invalidates any agreements "with respect to the treatment of any asbestos claim filed before the date of enactment of this Act that require future performance by any party."[4] (If the FAIR Act is passed, there may be debate concerning whether coverage-in-place agreements with insurers are within the scope of superceded agreements and, if not, whether there would be any remaining insurer obligations under such agreements in any event.)

Title I of the FAIR Act contains provisions that would likely limit the number of claims that would be filed with the Asbestos Court. Claimants will have to meet detailed medical criteria (which appear to be drawn from the recent criteria for the Johns Manville bankruptcy trust[5]) in order to be eligible for compensation. Once a claimant's impairment level has been established, the claimant is limited to a fixed recovery. A claimant with only asymptomatic exposure or low-grade asbestosis is only eligible for medical monitoring, whereas a claimant with mesothelioma is scheduled to receive $750,000.

INDUSTRY FUNDING OBLIGATIONS

Payments to claimants would be made through an Asbestos Injury Claims Resolution Fund (the "Fund") created by assessments levied on business and the insurance industry.[6] Each group will make a total aggregate contribution of $45 billion to the Fund. The amount due from each business entity would be established by reference to a system of Tiers and Subtiers, established by determining, respectively, the past asbestos expenditures of the business entity and its revenues. Certain business entities that are in bankruptcy as of the date of the FAIR Act, or that have gone through such proceedings within one year prior to the Act, would be assigned to Tier I (discussed in further detail below). Tiers II through VI would be based on prior asbestos defense and indemnification expenditures

1 *See* "Beginning Precarious Process, Hatch Introduces Asbestos Bill," Congress Daily, May 23, 2003 (noting significant opposition to the Act in the Senate from both Democrats and Republicans).

2 *See* Sections 101 and 403. "Asbestos claim" is defined in relevant part as "any personal injury claim for damages or other relief presented in a civil action or bankruptcy proceeding, arising out of, based on, or related to, in whole or in part, the health effects of exposure to asbestos." *See* Section 3(3)(A). Similarly, an "asbestos claimant" is defined as "an individual who files an asbestos claim." *See* Section 3(4).

3 Despite the bar on pending and future "asbestos claims," companies could still potentially face claims for contribution or indemnity brought by a historical asbestos defendant for sums paid prior to the Act's enactment.

4 See Sections 403(b)(1) (addressing entities within Tiers II – VI of the FAIR Act's funding criteria) and 202 (f) (addressing debtors in bankruptcy assigned to Tier I).

5 *See* "Hatch Trying to Win Democratic Backing for Asbestos Bill," Congress Daily, May 20, 2003.

6 *See* Sections 201-04.

(including expenditures that were covered by insurance).[7] Tier II includes companies with past expenditures of $75 million or greater, with the expenditure amount descending for each subsequent tier to a minimum threshold of $1,000,000.[8]

Business entities in Tiers II through VI would be then divided into three to five Subtiers based on revenues as reported to the SEC for 2002. Thus, a business with high past asbestos exposure and high revenues would initially pay up to $25 million per year, whereas a company with low prior asbestos expenditures and low gross revenues would pay as little as $100,000 per year. The FAIR Act would establish yearly aggregate minimum payments spread out over 27 years and totaling $45 billion (the aggregate cap for industry payments). The assessment amounts for each Subtier within Tiers II through VII will be reduced "in proportion" to the reductions of the aggregate minimums that occur at three- or five-year intervals. The Act does not specify what will happen if these aggregate yearly minimum payments, or overall industry target, are not met.

Companies required to contribute to the Fund would face certain reporting obligations. Within thirty days after the Fund administrator sends notice to the company or publishes such notice in the Federal Register, the company must provide all of the requested information necessary to calculate the amount of any required contribution to the Fund. The response must be certified by a responsible corporate officer under penalty of law as to its completeness and accuracy. Should a company fail to respond, the administrator will assess a contribution amount based on the "best information available."

The FAIR Act also would provide a means by which a company may challenge its assessment. For example, a company may qualify for an "inequity adjustment" if it can show that the amount of its contribution is "exceptionally inequitable" when measured against the amount of likely cost to that company of its future liability in the tort system in the absence of the FAIR Act. Such an adjustment will remain in effect for the life of the Fund, but the administrator of the Fund may only grant such an adjustment to the extent the financial condition of the Fund permits. A company may also seek a financial hardship adjustment lasting for three years (and renewable if the difficulties persist) if its statutory allocation would constitute a severe financial hardship on the company. The Fund administrator's discretion to grant such adjustments, however, is limited to 3% of the total annual aggregate contributions required of all industry participants.

EFFECT ON BANKRUPTCY PROCEEDINGS

Many companies have resorted to the bankruptcy process to resolve their asbestos liabilities, and the FAIR Act contains a number of provisions that may affect such proceedings. Tier I includes "debtors," defined to encompass all entities: (1) subject to Chapter 11 bankruptcy proceedings on the date of enactment or at any time during the year prior to enactment; (2) where a plan of reorganization has not been confirmed by final judgment; and (3) that have prior asbestos expenditures greater than $1,000,000. Tier I debtors with prior past asbestos expenditures of $1 million or greater would be assigned to Subtier 1 and assessed a fixed percentage (ranging from approximately 1.5% to .18%) of their revenues over the next 27 years. However, such debtors that have no material continuing business operations would be placed in either Subtier 2 or Subtier 3, based on whether they hold cash or other assets "allocated or earmarked" for asbestos settlements. If so, they would be placed

7 Tier VII is specifically reserved for railroads that have paid at least $5 million in asbestos claims under the Federal Employers' Liability Act. Assessments under Tier VII are made in addition to contributions such companies must make based on their assignment to one of Tiers II through VI.

8 Even if a company falls below the $1 million threshold, it nonetheless may not escape the provisions of the Act. The administrator of the Fund may assess up to $14 billion from "additional contributing participants," defined to include "any defendant in an asbestos claim that is not a mandatory participant . . . and is likely to avoid future civil liability as a result of this Act." *See* Section 225.

in Subtier 2 and required to transfer all of their assets to the Fund. If not, the debtor is placed in Subtier 3 and will be required to contribute 50% of its unencumbered assets to the Fund. Contributions to the Fund by Tier I debtors would be treated as costs of bankruptcy administration, and so have priority over most other claims.[9]

Certain Tier I debtors could escape the provisions of the Act if they qualify as "bankrupt business entities." To qualify, the debtor must have filed for bankruptcy before January 1, 2003, be without a confirmed plan of reorganization as of the date of the Act, and have a certification from a corporate officer that "asbestos liability was neither the sole nor precipitating cause for the filing under Chapter 11." Even if these criteria were met, the bankruptcy court must agree that confirmation is necessary and actually confirm a plan within nine months of the enactment of the FAIR Act in order to avoid having the Act apply.

A confirmed plan for a bankrupt business entity may include an asbestos trust. Payment to such a trust, by either a bankrupt business entity or an insurer, may be offset against any contribution to the Fund that business or insurer is obligated to make. With the apparent exception of these bankrupt business entity trusts, the Act requires that "the assets of any trust established to provide compensation for asbestos claims . . . shall be transferred to the Fund."[10]

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It is by no means clear whether the FAIR Act will be enacted, with or without significant changes, or that any asbestos reform legislation will be passed in the near future. Companies with asbestos liabilities are well advised, however, to monitor the progress of the legislation closely, as it may have a substantial impact on their current and ongoing strategies to resolve and to pursue insurance coverage for asbestos claims.

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9 *See* Section 402(c). Also of note is the fact that the FAIR Act would amend the bankruptcy laws to permit the enforcement of payment obligations thereunder regardless of the automatic stay and to provide that such obligations cannot be discharged in bankruptcy.

10 *See* Section 402(f).