

Bankruptcy Court Recommends Confirmation of NARCO and GIT Chapter 11 Plans

October 8, 2007

Decision determines that silica trust and channeling injunction are appropriate under Third Circuit standards.

On September 24, 2007, the U.S. Bankruptcy Court for the Western District of Pennsylvania issued an opinion recommending confirmation of the Chapter 11 plans of North American Refractory Company (NARCO) and Global Industrial Technologies, Inc. (GIT). The decision caps a five-and-a-half-year reorganization for the Pittsburgh, Pennsylvania-based family of industrial companies.

The NARCO plan provides for an asbestos personal injury claims trust and channeling injunction pursuant to section 524(g) of the Bankruptcy Code. The GIT plan provides for a separate asbestos trust and channeling injunction under Section 524(g), as well as a silica personal injury claims trust and channeling injunction pursuant to the Court's general injunctive powers under section 105. The Court's decision is significant because it concluded that the proposed silica trust and channeling injunction are necessary and appropriate, applying the rigorous standards applicable in the U.S. Court of Appeals for the Third Circuit, and despite the prevalent belief that many silica personal injury claims are of dubious merit, in light of the June 2005 decision in *In re Silica Products Liability Litigation*.

McDermott Will & Emery represents Honeywell International Inc., the NARCO plan funder in connection with these proceedings.

Background

NARCO and GIT produce refractory products, which are materials used in high-temperature industrial products, such as metal-melting furnaces, boilers and ladles. Honeywell owned NARCO from 1979 to 1986, when NARCO was sold to its management. NARCO was subsequently acquired by RHI AG, a global refractories enterprise based in Austria. Under the 1986 purchase agreement, NARCO assumed any products liability associated with non-discontinued products. NARCO's pre-sale product line contained more than 1800 products, but only a handful had ever contained asbestos. However, as asbestos claims began to be asserted against NARCO, Honeywell and NARCO were frequently in disagreement as to which of them was responsible for the claims. Prior to seeking bankruptcy relief, NARCO had faced approximately 290,000 separate asbestos claims, of which 115,000 were still pending. Over the same period, GIT faced approximately 425,000 asbestos and approximately 250 silica claims. On January 4, 2002, and February 14, 2002, NARCO and GIT commenced Chapter 11 cases in an effort to address the asbestos- and silica-related claims against them.

The Plans, Trusts and Channeling Injunctions

The NARCO plan provides for the creation of an asbestos trust and channeling injunction, pursuant to sections 524(g) of the Bankruptcy Code, in favor of, among others, NARCO and Honeywell, based on the practical difficulties associated with determining their respective asbestos claim liability. The GIT plan provides for the creation of an asbestos trust and channeling injunction and a silica trust and channeling injunction in favor of, among others, GIT and certain insurers, based on sections 105(a) and 1123(b)(6) of the Bankruptcy Code.

Although the confirmation of the NARCO plan was effectively uncontested, various insurers objected to confirmation of the GIT plan because of the inclusion of the silica trust. The thrust of the objections was that the current and future silica claims against GIT were overstated and unlikely to materialize in light of the increased scrutiny on silica claims following *Silica Products Liability Litigation*.

Judge Jack's Decision Regarding Silicosis Claims

District Judge Janis Jack's decision in *In re Silica Products Liability Litigation* was thought by some observers to sound the death knell for a substantial number of existing and future silicosis claims. In sum, after 20 months of pretrial proceedings and coordinated discovery, Judge Jack issued a comprehensive and highly critical decision which concluded that widespread fraud plagued the medical diagnosis of silicosis (see *In re Armstrong World Ind.*) Judge Jack concluded that, based on the cases before the court, silicosis appeared to be a "phantom epidemic, unnoticed by everyone other than those enmeshed in the legal system," including defendants, plaintiffs and the courts.

The Decision of the Bankruptcy Court

The Court confirmed the NARCO and GIT plans and concluded that the channeling injunctions should be issued regarding asbestos claims pursuant to section 524(g) of the Bankruptcy Code and regarding silica claims pursuant to sections 105(a) and 1123(b)(6) of the Bankruptcy Code.

The NARCO Asbestos Trust and Channeling Injunction

In its decision, the Court briefly addressed the injunction issued under the uncontested NARCO plan. It noted that NARCO and Honeywell were in agreement that it was impossible, as a practical matter, to determine which of them was responsible for the existing asbestos-related claims. Based on the manner in which the claims were alleged and on the 1,800 products in the NARCO product line, it would be a "laborious, time-intensive and extremely contentious effort" to determine which party was responsible in connection with a particular asbestos claim.

The Silica Trust and Channeling Injunction

The primary contested issue at GIT's confirmation hearing was GIT's need for a silica trust. GIT's arguments were that its subsidiary, A.P. Green Industries, Inc., had faced a small but meaningful number of silica claims pre-petition; GIT expected a substantial number of claims based on pre-petition silica exposures to be asserted post-confirmation; and A.P. Green would not have the financial resources to defend and resolve these claims absent the trust and

channeling injunction. The insurers countered that the number of pre-petition claims was too small to provide credible evidence about the likely number of post-confirmation claims, and that, in any event, the silica litigation landscape had been permanently altered in light of Judge Jack's decision, which would drastically reduce, if not eliminate, the number of future silica claims.

The trial relied on the testimony of expert witnesses. The debtors relied on Dr. Timothy Wyant, an epidemiologist and statistician, and Kevin Nystrom, the debtors' financial expert. Based on methodology that the Court found scientifically reliable, Dr. Wyant built a model that predicted that there would be between 10,360 and 23,304 silica claims asserted against GIT through the year 2050, with between 4,192 and 9,538 of those claims filed in the next 10 years. Relying on Dr. Wyant's estimate of the number of future claims, Mr. Nystrom testified that, even using the relatively low resolution value of \$4,700 per case (which was A.P. Green's average cost to defend and pay its pre-petition silica claims), the reorganized debtors would not be able to bear the expense of defending and settling these claims.

The objecting insurers relied on Dr. Denise Martin of NERA Associates for evidence on the epidemiological issues and Daniel Dooley of Morris-Anderson & Associates on financial issues. Dr. Martin, however, did not prepare an estimate of the number of silica claims that A.P. Green would face, but instead only criticized Dr. Wyant's analysis. The thrust of Dr. Martin's argument was that, in light of Judge Jack's decision, Dr. Wyant's number of projected future cases was wildly excessive, and that A.P. Green likely would face only 376 silica claims over the next 10 years. In particular, Dr. Martin testified that claimants who relied on diagnoses from Dr. Jay Segarra or Dr. Dominic Gaziano should be disregarded. Both doctors have served as the diagnosing physicians for large numbers of asbestos and silica claimants, in both the NARCO and GIT proceedings, and other cases.

In his testimony, Mr. Dooley excluded every claim that had been criticized by Dr. Martin. Based on his assumption that only 376 claims were likely to have economic value, he concluded that A.P. Green would have sufficient cash and insurance proceeds to pay these claims. Both witnesses for the insurers were effectively cross-examined, and the Court determined to credit the testimony of Dr. Wyant and to reject the testimony of the insurers' experts. Although Dr. Martin criticized Dr. Segarra and Dr. Gaziano, she conceded that claims submitted by these doctors are still accepted by the Manville Trust. Neither doctor had been criticized by Judge Jack or had been subject to the various state and federal fraud investigations arising out of the silica litigation. Moreover, even though she was critical of Dr. Wyant's failure to discount claims based on diagnoses by Dr. Segarra and Dr. Gaziano, Dr. Martin admitted that her own firm, NERA, did not discount claims based on diagnoses submitted by those doctors in NERA's estimation of current and future silica claims in the Swan Transportation Co. Chapter 11 case. As a result, the Court found that there was no basis to exclude diagnoses submitted by these doctors.

The Court was plainly skeptical of Mr. Dooley's testimony. His testimony was based on reducing the number of likely claims estimated by Dr. Wyant by 92 percent and labeling the resulting figure as the "most likely case." The Court observed that "Mr. Dooley's manipulation of the number of current claims compels the conclusion that only 8 percent of the current claims have economic value. This conclusion excludes consideration of 'nuisance value' encompassed by defense costs. Such a conclusion is unrealistic and is not supported by the evidence."

In its ruling on the legal issues, the Court first observed that under section 105(a), other courts have approved channeling injunctions to resolve non-asbestos liabilities, including liabilities related to securities class action claims, silicone breast implants, Dalkon Shield birth control devices, silica, coal tar pitch volatiles and noise-induced hearing loss.

Next, the Court analyzed the injunction under the leading case in the Third Circuit, *Gillman v. Continental Airlines*. Under *Continental*, courts may approve channeling injunctions in "extraordinary cases." To approve such an injunction, a court must conclude that it is fair and necessary to the reorganization, and specific factual findings must support those conclusions.

Necessity of Injunctions to Reorganization

The Court concluded that, based on the evidence presented to it, the silica trust and channeling injunctions were necessary to GIT's reorganization. The Court first considered the number of current and projected silica claims and the economic burden associated therewith. The Wyant report projected that 10,360 to 23,304 silica claims would be asserted against GIT between 2016 and 2050. The Court determined that the Wyant report adequately documented its studies and models, and used reliable and scientific foundations to determine the number of future claims against GIT.

Next, the Court considered the validity of the current silica claims. The Court rejected the insurers' arguments that current silica claims supported by Dr. Segarra or Dr. Gaziano should be excluded from the claim pool. In rejecting this argument, the Court noted that neither doctor was among the doctors whose practices were criticized by Judge Jack in the *Silica Products Liability Litigation* and who have been subject to various state and/or federal fraud investigations.

Finally, the Court considered the potential defense costs. It noted that even if the insurers' arguments were correct that certain of the silica claims would ultimately not be compensable, GIT would still incur substantial defense costs associated with a final determination on those claims. The defense costs in these types of cases are typically in the range of 25 to 30 percent of the indemnity costs. Accordingly, taking into account even a very low resolution value per claim, plus reasonable defense costs, the economic burden on GIT would range between \$28 million and \$117 million between 2010 and 2050. Based on the resources available to GIT, without the benefit of the silica trust and channeling injunction, the Court found that the economic burden could cripple reorganized GIT.

Conclusions

In light of the significant evidentiary hurdles imposed under Third Circuit law and the findings of Judge Jack in other silica litigation, the approval of the NARCO and GIT plans with the silica trust and channeling injunction is significant in several respects. First, the decision represents another instance in which a bankruptcy court has used a section 105(a) injunction to sanction a settlement trust and channeling injunction in a non-asbestos mass tort context. The decision also illustrates the type of evidentiary presentation debtors will have to make to obtain the benefits of such

an injunction. For objectors to such injunctions, the opinion presents an equally clear lesson: the Court was critical of the objectors' failure to present any evidence of the number of silica claims the debtor would face, and their reliance on mere criticism of the debtor's expert witness. The lesson to be drawn for objectors is that to rebut a debtor's *prima facie* case, objectors must present a credible alternative claim estimation.