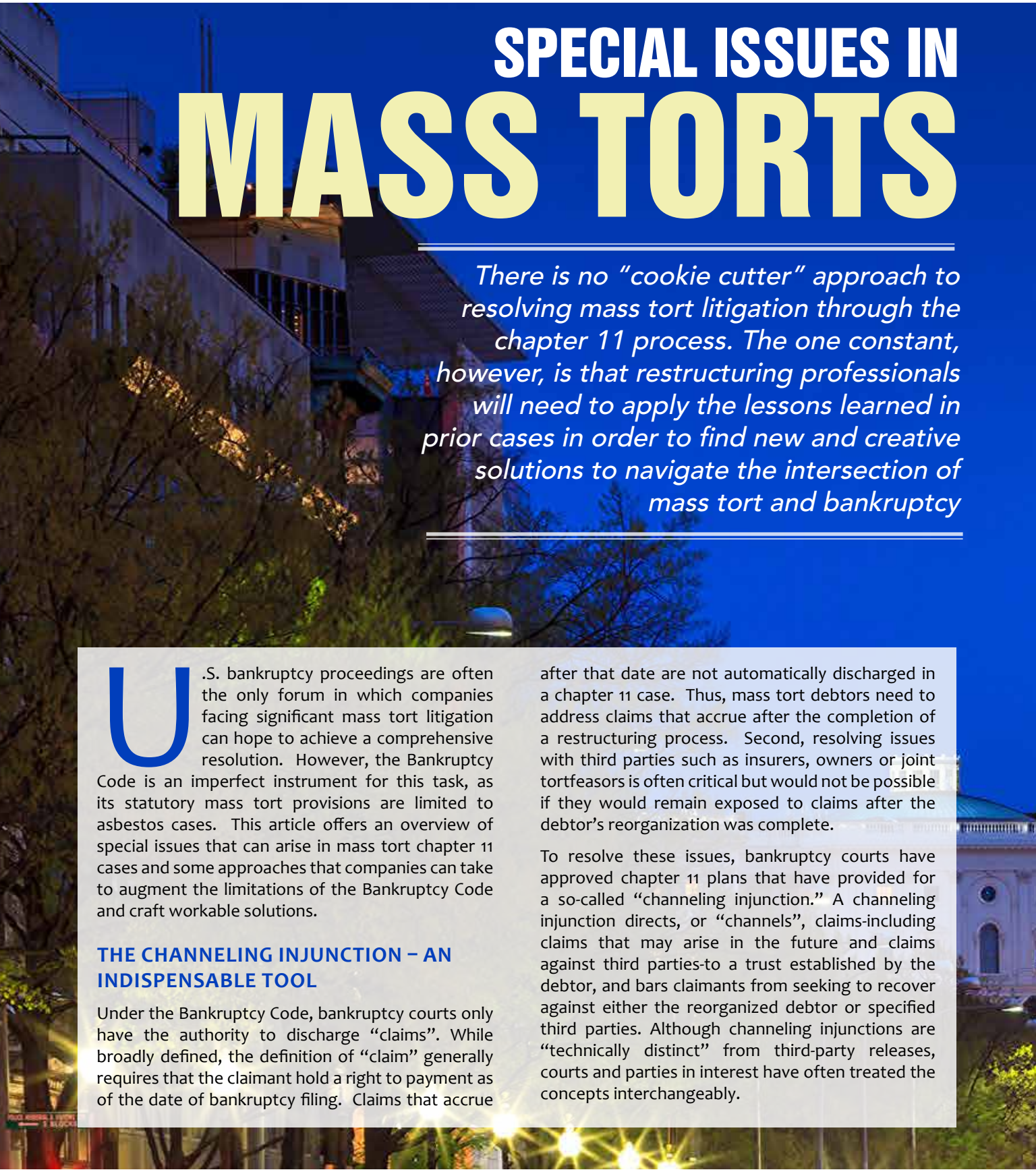

SPECIAL ISSUES IN MASS TORTS

There is no "cookie cutter" approach to resolving mass tort litigation through the chapter 11 process. The one constant, however, is that restructuring professionals will need to apply the lessons learned in prior cases in order to find new and creative solutions to navigate the intersection of mass tort and bankruptcy

U.S. bankruptcy proceedings are often the only forum in which companies facing significant mass tort litigation can hope to achieve a comprehensive resolution. However, the Bankruptcy Code is an imperfect instrument for this task, as its statutory mass tort provisions are limited to asbestos cases. This article offers an overview of special issues that can arise in mass tort chapter 11 cases and some approaches that companies can take to augment the limitations of the Bankruptcy Code and craft workable solutions.

THE CHANNELING INJUNCTION – AN INDISPENSABLE TOOL

Under the Bankruptcy Code, bankruptcy courts only have the authority to discharge "claims". While broadly defined, the definition of "claim" generally requires that the claimant hold a right to payment as of the date of bankruptcy filing. Claims that accrue after that date are not automatically discharged in a chapter 11 case. Thus, mass tort debtors need to address claims that accrue after the completion of a restructuring process. Second, resolving issues with third parties such as insurers, owners or joint tortfeasors is often critical but would not be possible if they would remain exposed to claims after the debtor's reorganization was complete.

To resolve these issues, bankruptcy courts have approved chapter 11 plans that have provided for a so-called "channeling injunction." A channeling injunction directs, or "channels", claims-including claims that may arise in the future and claims against third parties-to a trust established by the debtor, and bars claimants from seeking to recover against either the reorganized debtor or specified third parties. Although channeling injunctions are "technically distinct" from third-party releases, courts and parties in interest have often treated the concepts interchangeably.

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IMPLEMENTING A CHANNELING INJUNCTION OUTSIDE OF THE ASBESTOS CONTEXT

The first channeling injunction was issued by a bankruptcy court in the Johns-Manville chapter 11 case to address the possibility of future suits by tens of thousands of as yet unknown individuals who had been exposed to the company's asbestos-containing products. In 1994, Congress codified the approach taken by Davis Polk in *Johns-Manville* by amending the Bankruptcy Code to provide for the availability of and standards for channeling injunctions in asbestos cases-and only asbestos cases-under section 524(g).

Courts in many U.S. jurisdictions have nevertheless generally held that channeling injunctions can be obtained outside the asbestos context pursuant to the court's equitable powers, for example in cases involving securities fraud, deceptive business practices, injuries caused by defective products, and consumer fraud claims. The pro-release courts are in general agreement that third-party releases and permanent injunctions should be used solely in "extraordinary circumstances," though the standards they have adopted to evaluate these circumstances vary. One common element, however, is that the plan of reorganization must have the "overwhelming" support of the creditors whose claims would be channeled. The threshold for a plan to have "overwhelming" creditor support is unclear, though it likely means measurably more than the 50% required by section 1126 of the Bankruptcy Code

for a class to accept a plan. Given the lack of specific precedent, courts may by analogy apply the 75% acceptance threshold required in the asbestos context under section 524(g).

OBTAINING CREDITOR SUPPORT FROM CONTINGENT LITIGATION CLAIMANTS

The nature of the claims asserted in mass tort bankruptcies creates at least two notable obstacles to obtaining creditor support for a plan of reorganization. First, determining the amount of potential claims at issue, and thereby ultimate creditor recoveries, is an important aspect of establishing a trust or trusts in connection with a channeling injunction and confirming a chapter 11 plan. This process can become extremely complicated when plaintiffs include not only individuals but also governments, insurers, and other creditor groups, each asserting claims that are potentially duplicative of other creditors' claims and each with their own likelihood of success on the merits. Section 502(c) of the Bankruptcy Code requires that a court estimate any contingent or unliquidated claim if its liquidation would "unduly delay the administration of the case." The Bankruptcy Code is silent as to how contingent or unliquidated claims are to be estimated, though courts have approved various forms of estimation procedures developed on a case-by-case basis. Because estimation proceedings can themselves be complex and highly contentious, debtors often instead seek to settle claims' estimation issues in the channeling injunction context, potentially through a court-approved mediation process.

Second, it is not always clear who appropriately speaks for significant litigation claimants within a given class. For example, representatives of a putative class seeking class certification in a non-bankruptcy forum may purport to speak for many similarly-situated claimants but often do not have the authority to act for all such claimants. And governmental claimants at many levels, including city, county, state and federal, may claim to speak for the same citizens.

ADDITIONAL CONSIDERATIONS IN MASS TORT CASES WITH GOVERNMENTAL PLAINTIFFS

The presence of governmental plaintiffs raises additional complications to those noted above. For example, governmental entities may be unable, legally or practically, to execute a traditional restructuring support agreement. Moreover, in certain cases governmental plaintiffs will allege that their actions are exempt from the automatic stay by virtue of the section 362(b)(4) police and regulatory power exception. In such cases, a debtor may have to seek a preliminary injunction to enjoin the continued prosecution of active governmental litigation against the company and potentially against related third parties as well. Finally, governmental actors may be unwilling or unable

to accept certain forms of consideration, or may have aims different from, and possibly in direct tension with, those of many other parties in the case and misaligned with the maximization of value.

ACHIEVING A COMPREHENSIVE RESOLUTION – CREATIVITY IS KEY

There is no "cookie cutter" approach to resolving mass tort litigation through the chapter 11 process. There are simply too many variables, including the nature of the alleged harm, the number of potential claimants and the identities and interests of those claimants, the presence of significant non-litigation creditors (e.g., funded debt creditors), and the company's industry, ongoing operations and regulatory environment. The one constant, however, is that restructuring professionals will need to apply the lessons learned in prior cases in order to find new and creative solutions to navigate the intersection of mass tort and bankruptcy. For instance, Davis Polk continues to break new ground in its representation of Purdue Pharma in its chapter 11 cases. The Purdue bankruptcy has required the application of existing tools in new ways, including a preliminary injunction (obtained over numerous objections) staying thousands of lawsuits brought by governmental claimants, an unprecedented noticing program that resulted in over 600,000 timely claims filed against the estates, and a month-long mediation process to reach agreement on the allocation of estate value among creditors asserting trillions of dollars of claims. Given the nature of mass tort bankruptcies, the next mass tort case will likely look very little like Purdue. However, the experience gained from this matter and others will likely form the foundation for new and novel solutions in cases to come.

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Marshall Huebner is Global Co-Head of Davis Polk's Restructuring Group. He is widely recognized as one of the country's leading practitioners, and is one of only a handful of restructuring lawyers to have been twice-named a "Dealmaker of the Year" by The American Lawyer. Mr. Huebner routinely represents financial institutions and companies in major restructurings and bankruptcies, and has advised on many of the largest and most complex of such matters yet done. Among his major representations, he has served as lead counsel to: the Federal Reserve Bank of New York and the U.S. Department of the Treasury in AIG, the joint administrators and liquidators of Lehman Brothers International (Europe) and its U.K. Lehman affiliates, Delta Air Lines, the administrative agent in Hertz, Purdue Pharma, Citibank in Lyondell, Ford Motor Company, Arch Coal, James River Coal, Patriot Coal, Bonanza Creek Energy, Magnetation, Frontier Airlines, Pinnacle Airlines, Pernix Therapeutics and The Star Tribune Company. Mr. Huebner has received numerous honors and is regularly included in listings of top restructuring lawyers published by the various rankings and publications that track the profession. He also lectures widely at multiple law schools and industry conferences.

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