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## Leaving The Tort System Behind Via Corporate Risk Transfer

By **Mark Hemmann and Peter Kelso** (May 27, 2020, 5:15 PM EDT)

On May 15, cosmetic talc supplier Imerys Talc America Inc. filed a Chapter 11 plan of bankruptcy reorganization seeking to resolve more than 16,000 personal-injury claims alleging mesothelioma and ovarian cancer from exposure to talc.[1] Less than a decade earlier, when French multinational company Imerys SA acquired the company and its affiliates in 2011, Imerys faced only eight talc personal-injury claims.[2]

This dramatic rise in lawsuit volume is not uncommon in the world of asbestos and mass tort litigation — where claims can be quickly aggregated in class actions, multidistrict litigation and bankruptcy — and highlights the uncertainty of claim patterns and causation arguments in a volatile tort system.

Recent notable examples of this dynamic include emerging liability theories and the consolidation of cases against corporate defendants in litigations such as asbestos, glyphosate, PFAS and talc. The uncertainty that this rise in litigation — with emerging and contested causation and scientific evidence — presents to corporate defendants cannot be overstated.

Regardless of economic and legal conditions, legacy product and environmental liabilities hinder companies' ability to operate efficiently and remain financially nimble in an ever-changing marketplace. Whether a company is private or public, the cost of managing and resolving an ongoing stream of lawsuits can be time-consuming, damaging to the firm's reputation, and a financial drag on business operations and performance.

Further complicating the current and future management of legacy liabilities is the inherent latent nature of the claims and alleged damages. In some cases, the liabilities were obtained through either the historical operations of a subsidiary or a merger or acquisition decades earlier.

It is common that these legacy liabilities are passed through to generations of new management, who must continue to deal with the legal and financial impact of running off the loss. In essence, this is the legacy of contingent liabilities.

In many cases, legacy liabilities stem from latent personal injury or environmental damage allegedly caused by toxic product exposure or pollution. In cases of environmental contamination, the cost of investigation and remediation can take years, if not decades, in addition to time spent dealing with community property damage claims, or even claims of medical monitoring and personal injury.

In cases of product liability, such as asbestos, the latent nature of alleged exposure and disease creates a long-tail manifestation of claims and litigation that can span decades, resulting in a level of intermediate- and long-term uncertainty that can make strategic corporate planning difficult. As a result, the financial growth of defendant companies can often stagnate, and companies are often restricted from the economic freedom to realize their full potential due to the uncertainty of litigation.



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Often, long-tail liabilities involving personal injury claims stemming from allegations of toxic product or environmental exposures will manifest in either a mass tort or class action — with the latter generating a large aggregation of claims in the near term, while the former can yield a steady stream of individual claims over the course of years or even decades. In environmental actions, costs for remediation and natural resource damage claims can confound the volume of toxic tort personal injury claims.

In any case, the sheer volume of claims, and the sizable demands, are costly to resolve, and will often result in financial distress for an impacted company, even if there is insurance coverage against these claims.

Frequently, the largest liability on an impacted company's balance sheet is in the form of a contingent liability, or a quantified estimate of the unknown future asbestos claims or other litigation. It weighs heavily on a company's finances, impacts the direction and flexibility of a company's operations, and limits a company's options.

Even in a mature mass tort such as asbestos, the list of companies named in lawsuits continues to expand. Currently, there are thousands of defendant companies involved in the litigation, many of which have seen their liability profile grow exponentially from just five or 10 years ago. As the matrix of claims shifts to new allegations and theories of exposure and disease, new companies find themselves faced with unanticipated legal expenses and future uncertainty.

For example, in 2008 ArvinMeritor (now known as Meritor Inc.) set a 10-year reserve of \$51 million for its operating unit Maremont Corp.'s asbestos claims.[3] By 2018, the 10-year reserve increased to \$68M, and in 2019 the company decided to put Maremont into bankruptcy reorganization in an attempt to ring-fence the liability.[4]

The Maremont experience, much like Imerys' claims history leading up to its bankruptcy, is not unique. Asbestos litigation is littered with public and privately owned defendant companies once considered peripheral and now on the frontlines of the litigation.

### **Historical Options to Resolve Asbestos and Other Contingent Liabilities**

Traditionally, the only exit option from litigation for companies holding legacy liabilities has been through bankruptcy reorganization. This has been especially true for asbestos and other mass torts.

The bankruptcy process is complicated, laborious, adversarial and expensive, and the timing is uncertain, with multiple counsels, and reliance upon court-assigned bankruptcy trustees, creditors and committees. In regard to asbestos litigation, there have been recent structural concerns raised with Section 524(g) of the Bankruptcy Code, the bankruptcy mechanism for asbestos claims that allows companies to resolve current and future asbestos liabilities through the establishment of a settlement trust.

The U.S. Department of Justice, the Office of the U.S. Trustee and other parties have recently intervened in several pending asbestos bankruptcies, and called into question many of the processes and inequities inherent in the 524(g) process.[5] Going forward, this intervention may threaten the ability of asbestos defendants to effectively use bankruptcy as a means of global resolution.

Outside bankruptcy, another potential exit option is to insure against contingent liabilities. Although traditional insurance is no longer available for asbestos defendants, several specialty insurance companies have developed a market for the insurance of such exposures.

However, such insurance is rarely either sufficient or affordable enough to satisfy such claims and litigation over the course of at least 30 years, which is the usual timeframe necessitated to reserve for contingent liabilities. Moreover, insurance does not remove the ultimate obligation from a company; the company still bears the potentially devastating risks of an unexpected and substantial adverse judgment, a new set of alleged exposures (such as talc for asbestos defendants), or a change in public policy or law.

### **The Capital Markets Solution**

So what do you do if you are leading and managing a company mired with legacy liabilities and contingent risk? Is there a better way to strategically transfer the liabilities outside the bankruptcy process and exit the tort system?

The resounding answer is "yes." Encumbered holders of these risks are seeking to complete the sale of legacy contingent liabilities through an arms-length transaction to a third-party purchaser.

So why is it good for the seller? In one word, this corporate transaction provides finality. The direct sale of these contingent liabilities or through the sale of an entity or affiliated company holding the contingent risk removes the liabilities from the seller's balance sheet, permanently.

There is no more forecasting and reserving, and the headaches and uncertainty about the impact to future operations is removed. The corporate risk transfer transactions are usually significantly less expensive than traditional insurance options, and the relationship is not adversarial — the impacted company is engaging with a motivated purchaser of its liabilities.

The transactions are vetted by legal and financial experts, who ensure that the seller does not risk any future obligations in regards to latent liability claims. That risk is completely transferred to the purchaser and acquiring entity.

Other reasons for pursuing a corporate risk transfer transaction include cost and improvement in operations. While there is some cost to the transaction, it ultimately will be magnitudes less than the cost of pursuing bankruptcy or insurance.

Operationally, a company can reduce its claims management staff, refocus its efforts on its core business and improve its balance sheet. The latter, in particular, is a qualitative improvement that can make possible follow-on options for the seller, including better coverage and terms from banks and Wall Street, improved prospects for mergers and acquisitions or other strategic activities, and confidence from customers, partners and investors that the company's prospects and future have improved.

In short, a sale of contingent liabilities to a third-party acquirer allows an impacted company to globally resolve legacy litigation. The transaction is final and comparatively faster, less expensive, and provides more certainty than other options.

With the growth of a more dangerous and litigious tort environment for corporate defendants, companies holding legacy liabilities should view corporate risk transfer as a viable alternative to exiting the tort system, and investigate a capital markets solution to see if it matches their strategic vision.

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[1] In re: Imerys Talc America Inc. et al., Joint Chapter 11 Plan of Reorganization of Imerys Talc America Inc. and its Debtor Affiliates Under Chapter 11 of the Bankruptcy Code, No. 19-10289, D. Del. Bkcy., May 15, 2020.

[2] In re: Imerys Talc America Inc. et al., Disclosure Statement for Joint Chapter 11 Plan of Reorganization of Imerys Talc America Inc. and its Debtor Affiliates Under Chapter 11 of the Bankruptcy Code, No. 19-10289, D. Del. Bkcy., May 15, 2020, Pg. 19.

[3] <https://www.sec.gov/Archives/edgar/data/1113256/000116923208004368/arm10k.htm>.

[4] <https://www.sec.gov/Archives/edgar/data/1113256/000111325618000120/mtor->

20180930x10k.htm; <https://investors.meritor.com/news-releases/news-release-details/maremont-corporation-meritor-inc-non-operating-subsidiary-files>.

[5] In re: Paddock Enterprises LLC, United States Trustee's Motion for an Order Directing the Appointment of an Examiner, No. 20-10028, D. Del., Bkcy., Feb. 24, 2020; <https://www.justice.gov/opa/pr/justice-department-files-statement-interest-new-asbestos-trust-proposal>.

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