

Chapter 11 and Asbestos: Encouraging Private Enterprise or Conspiring to Avoid Liability?

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ABSTRACT. This paper explores the American bankruptcy system – especially the Chapter 11 code – which since 1978 has allowed insolvent companies the opportunity to restructure and reorganise with the benefit of court protection from creditors. Particular attention is focused on asbestos companies, such as Johns-Manville, which have been among the most consistent and controversial filers for bankruptcy under Chapter 11. The history of asbestos and Chapter 11 is explored, against the backdrop of the burgeoning asbestos “crisis”, caused by increasing mortality and litigation. Some of the business and ethical issues involved are highlighted by examining in detail a recent bankruptcy (Federal Mogul/T&N in 2001) that has implications in both Britain and America. Chapter 11 bankruptcy is evaluated, particularly in the light of the trend towards similar mechanisms of insolvency in the UK, Europe and the rest of the world. It is concluded that, certainly as regards the experience with asbestos, Chapter 11 offers an inefficient and inequitable method of rehabilitating or rescuing failing businesses.

KEY WORDS: asbestos, chapter 11, bankruptcy, insolvency, Johns-Manville, Federal Mogul, Turner & Newall.

All professions are conspiracies against the laity.

– George Bernard Shaw, *The Doctor's Dilemma* (1911) Act 1.

Introduction

Bankruptcies are in the news again, particularly in America. As one financial journal has remarked: “Bankruptcy lawyers, turnaround managers and vulture investors have never been busier” (London, 2001). The spectacular collapse of Enron and WorldCom has focused attention on the way in which economies deal with bankrupt companies. High-profile bankruptcies in the USA have familiarised UK observers with the term “Chapter 11” – a fundamental bankruptcy mechanism that since the late 1970s has been used by American executives to restructure their ailing businesses. Thousands of companies have sought shelter in Chapter 11. These have included relatively obscure companies, but some have been the biggest organisations in corporate America, such as Continental, Pan-American, and Conesco. The trend towards Chapter 11 has accelerated recently: a record 257 companies filed for bankruptcy protection under the code in 2002.

This is not the first time that Chapter 11 has been in the headlines. Few companies have used Chapter 11 so consistently or so controversially as those in the asbestos industry. This paper explores the history of

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asbestos and Chapter 11, examines some of the business and ethical issues involved, and describes a recent bankruptcy that has implications in both Britain and America. Chapter 11 bankruptcy is evaluated, particularly in the light of the trend towards similar mechanisms of insolvency in the UK, Europe and the rest of the world. It is concluded that, certainly as regards the experience with toxic hazards, Chapter 11 offers an inefficient and inequitable model for rehabilitating or rescuing companies.

American bankruptcy and Chapter 11

In the US, early bankruptcy laws were temporary measures passed in response to harsh economic conditions. The primary focus was on recovering the investments of the creditors; tradesmen unable to pay their debts were dealt with harshly (Skeel Jnr., 2001). Bankruptcy laws later became permanent and have been periodically amended. The Bankruptcy Act (1878), which first extended protection to corporations from creditors, is the foundation of modern US bankruptcy laws. As American law developed in the 20th century, only insolvent firms could file for bankruptcy. Once this happened, managers were replaced by government trustees; and there was considerable stigma surrounding the event.

Recently, the emphasis has switched to the rehabilitation of the debtor/company through reorganisation. The Bankruptcy Reform Act (1978) marked the start of a new era. Debtors filing for complete dismissal can use the so-called Chapter 7 bankruptcy code; but there is another and easier route through the bankruptcy procedure via Chapter 11. Companies do not need to be insolvent (they only need to demonstrate imminent insolvency). Other key features of the Chapter 11 procedure that make it attractive to company managements throughout the world are a moratorium, an opportunity to restructure the firm's finances, and a mechanism to force creditors to compromise. For businesses, Chapter 11 has several advantages compared with other insolvency systems owing to its emphasis on company rescue rather than liquidation. Chapter 11 importantly offers "debtor-in-possession" financing, which usually allows the company to retain its existing management. These managers

have the right to file a plan of reorganisation. The lack of stigma attached to this process is said to be important for managers in retaining the confidence of their customers. Restructured companies can emerge from Chapter 11 relatively unscathed, unlike the process of administrative receivership in the UK. Another advantage is the frequent willingness of the US courts to override minority shareholders' objections and allow debt-for-equity exchanges. An interesting provision of current Chapter 11 law is that lawyers' fees can be charged at market rates, whereas formerly these fees were restricted.

A company in Chapter 11 does not usually emerge without some damage: some chief executives and managers can lose their jobs; suppliers and customers can become reluctant to deal with the company; and the court has to be consulted on almost every key issue, such as the sale of assets or investments. However, it does not take a sophisticated analysis to see that the American bankruptcy code is debtor-oriented and that creditors have few rights. In other words, it is lenient towards business and this, its supporters argue, encourages a culture of enterprise. Certainly it proved an attractive option in 1980s, when filings for Chapter 11 bankruptcy escalated.

However, Chapter 11 has also invited criticism – even in the business world. First there are the moral hazards involved in bankruptcy (Kilpi, 1998). The ethics of Chapter 11 were analysed by Salem and Martin (1994). They noted that some corporate advisers were promoting the use of bankruptcy as an early and proactive decision when facing economic uncertainty and rising indebtedness. This line of advocacy effectively eliminated the punitive aspects of bankruptcy by allowing the firm's senior executives to keep their jobs, or obtain generous severance packages, or accept inducements to "stay on" in the firm. Salem and Martin condemned this and called for a public debate about the court's obligation to consider the public good in such Chapter 11 petitions. After all, they noted:

Firms should not be allowed to lose sight of the fact that there is a debt incurred and owed. Creditors' claims should have a greater priority than shareholder's investment, who as owners of a firm, should be prepared to share its profits as well as losses (Salem and Martin, 1994, p. 102).

Salem and Martin also called for reform of the US bankruptcy code, so that the courts could give greater scrutiny to the reasons given for a reorganization petition under Chapter 11 and take into account the events that initially led to the petition. Salem and Martin also believed that victims' voices in this process should receive more attention.

Aside from the moral issues raised by Chapter 11, another key question is whether it works as a mechanism for restructuring. Competitors argue that bankrupt businesses can renege on contracts, eliminate borrowing, and cut prices. Moreover, sample studies have shown that a large percentage (between 32 and 40%) of Chapter 11 companies continue to suffer operating losses and often need further restructuring (Hotchkiss, 1995; LoPucki and Kalin, 2001). These companies are usually liquidated or file again for bankruptcy. For example, airline companies are the biggest repeat filers for Chapter 11. Since the airline industry was deregulated in 1978 (the same year as the Bankruptcy Reform Act), 11 major carriers have filed for court protection. Yet the only turnaround success story has been Continental Airlines, and that needed a second attempt (*Financial Times*, 9 December 2002). Other companies have limped from crisis to crisis. This suggests that the fundamental rationale for Chapter 11 – that it encourages enterprises to flourish and recover – is a false one and that the mechanism may actually hinder the market mechanism by making it difficult for the economy to remove excess capacity (London, 2002). Others suggest that Chapter 11 encourages venality, with states such as Delaware “shopping” for the bankruptcy business, because favourable state laws can attract Chapter 11 filings and thus bring millions of dollars to the local legal community.

Overall, these criticisms have so far made no difference to the workings of Chapter 11 – a system that still has its supporters (Warren, 1992–1993). For the moment, the structure of the US bankruptcy process remains strongly rehabilitative rather than punitive for all petitioners. However, the recent Enron catastrophe may generate sufficient public concern for a comprehensive review of company law in the US, including its bankruptcy code. The experience with the burgeoning asbestos “crisis” in the last few years may provide further impetus for another look at Chapter 11.

Asbestos and Chapter 11

In the 1990s, reports of bankrupt American asbestos companies and multi-million dollar asbestos lawsuits became a staple of media reporting. For most of the 20th century, however, asbestos (a mineral) was regarded as a lifesaving material because of its fireproof qualities. It was widely used in industry (for insulation and construction) and in the home (in a myriad of products, such as ironing pads and oven mitts). The leading companies were multinationals, with asbestos mines in South Africa and Canada, and manufacturing plants around the world. As the industry reached its peak in the 1970s, however, it began to pay the price for the manufacture of a health hazard.

Even at the beginning of the 20th century, lung damage caused by inhaling asbestos dust was recognised in the UK as a severe health risk for workers (Gee and Greenberg, 2001). By the 1920s, doctors had described a new medical condition: asbestosis (or lung scarring caused by the microscopically fine, but harsh, fibres of asbestos). During the 1940s and 1950s, it also became apparent that asbestos dust could trigger fatal lung and abdominal cancers – one of the most malignant of which was mesothelioma (Selikoff and Lee, 1978; Tweedale, 2002). The mortality from these diseases was not enough to limit the use of asbestos or encourage the industry dramatically to improve dust control: asbestos was too profitable and useful. Moreover, until the 1950s and 1960s, litigation in the US (and the UK) against the asbestos firms was almost unknown. The legal costs of proving negligence against a major company were overwhelming for individual workers (Wikeley, 1983). The only compensation in the US for personal injury from asbestos was modest amounts from state compensation (or in the UK, from a limited national insurance scheme).

What happened next, in the 1970s and 1980s, is often described as the explosion of an asbestos “bomb”. Its detonation had been primed by two factors. First, the latency of asbestos diseases, particularly mesothelioma (which has a latency of between 30 and 50 years). Second, the heavy exposures suffered by workers (and by other individuals) in the 1940s and 1950s, which caused a marked rise in mortality in the last decades of the 20th century. No one knows the present mortality

from asbestos in the US: but it probably reaches 10,000 deaths a year, with many thousands suffering some symptoms of lung damage. In the UK, well over 3000 individuals die each year from asbestos-related disease – a number that has been rising since the 1960s. In Europe, the asbestos “epidemic” may kill about 1/2 million individuals by 2030 (Peto et al., 1999).

This precipitated the largest wave of litigation in history as American plaintiffs and their lawyers launched thousands of suits against the asbestos industry. A key development in opening the flood-gates of litigation involved changes to American product liability law. In a landmark legal action, launched in 1973 by mesothelioma sufferer Clarence Borel against asbestos company Fibreboard (and several other makers), the manufacturers were found liable under product liability law for their “failure to warn”. Court cases could now be won on this issue (rather than on the narrow one of negligence), widening the field of potential claimants. Typically, claimants had been exposed while working for different employers, so it was in their interests to file multiple claims. In turn, producers being sued might issue cross-complaints against other manufacturers. Litigation snowballed even more when lawyers used legal “discovery” to show that the leading asbestos companies had known about asbestos diseases for decades: indeed, many of them had a track record of conspiring to hide the hazards of their product from workers and the public (McCulloch, 2002; Ozonoff, 1988).

A new branch of the legal industry was spawned by asbestos. Before 1980, less than a thousand asbestos cases were filed in the US courts. By the end of 1988, the figure had surpassed 100,000; and by 2001, over 1/2 million cases had been filed. Also significant was the size of American personal-injury awards, which frequently registered millions of dollars, with substantial amounts awarded by juries for punitive damages. Lawyers’ contingency fees (which routinely range between 25 and 40%) and other legal costs were also substantial. For class action suits these could reach hundreds of millions of dollars.

Soon the asbestos companies launched evasive action. In 1982, Johns-Manville – then the world’s largest producer of asbestos – sought refuge in Chapter 11 from thousands of lawsuits. Because

TABLE I
Manufacturers filing for Chapter 11 due to asbestos liabilities

Date	Company
1982	Amatex Johns-Manville Unarco
1984	Wallace & Gale
1985	Forty-Eight Insulations
1986	Pacor Prudential Lines Standard Insulations Inc. United States Lines
1987	Nicolet Todd Shipyards Gatke Corporation
1988	Brunswick Fabricators, Inc. Waterman Steamship Corporation
1989	Hillsborough Holdings Raymark (formerly Raybestos-Manhattan) Delaware Insulations
1990	Carey Canada Celotex Philip Carey Company National Gypsum Standard Manufacturing Asbestos & Insulation
1991	Eagle-Picher Industries H. K. Porter
1992	Kentile Floors Cassiar Mines
1993	American Shipbuilding Baldwin Ehret Hill Fibreboard Corporation (Trust) Keene Corporation
1995	Lykes Brothers Steamship
1996	Rock Wool Manufacturing
1998	SGL Carbon M.H. Detrick Fuller-Austin Insulation Brunswick Fabrications Atlas Corporation
1999	Rutland Fire Clay Joy Technologies
2000	Armstrong World Industries Babcock & Wilcox Owens-Corning Pittsburgh Corning Burns & Row Enterprises
2001	Bethlehem Steel E. J. Bartells Federal-Mogul/T&N

TABLE I (Continued)

Date	Company
2002	G-I Holdings (formerly GAF)
	United States Gypsum
	United States Mineral Products
	W. R. Grace
	Eastco Industrial Safety Corporation
	Skinner Engine Company
	Washington Group International
	AC&S
	A. P. Green
	Harbison-Walker Refractory Company
2003	Kaiser Aluminum
	North American Refractories (NARCO)
	Synkoloid (Artra Group)
	J. T. Thorpe & Company
	Combustion Engineering
	Proko Industries 2004 Flintkote

Sources: Worthington (2003); Bowker (2003, p. 270); personal information.

Johns-Manville was such a prominent American company (it had assets of \$2 billion and was ranked 181st on *Fortune's* list of the nation's 500 leading industrial corporations), the story made the front pages of almost every major US newspaper. The fact that the company was one of the most financially healthy ever to seek Chapter 11 generated a heated controversy (Calhoun and Hiller, 1988). However, 16 more companies filed for bankruptcy in the 1980s, due to their asbestos liabilities; followed by another 22 in the 1990s (Table I).

In the late 1990s, it seemed that the flood of litigation would, if not cease, at least slacken. Almost all the major asbestos companies had filed for Chapter 11. However, the rate of bankruptcies actually increased between 2000 and 2004, with over 20 companies using Chapter 11 as an escape from personal-injury liabilities (bringing the total to over 60 companies by the end of 2002). This is unlikely to be the end. Presently, Halliburton – the oil-services company formerly run by US vice-president Dick Cheney – faces 300,000 asbestos claims that will cost (according to a recently proposed settlement) \$4 billion over the next 15 years (Associated Press, 2002; Teather, 2002). The liability stemmed from Dresser Industries, a maker of pipe-

line couplings, that was acquired by Cheney in 1998. Georgia-Pacific, an Atlanta-based wood and building products conglomerate that used asbestos until 1977, has resolved 250,000 claims so far, but projects that it will need to pay \$1 billion over the next decade (*Atlanta Journal-Constitution*, 2002).

Various explanations have been advanced for the sheer volume of claims. It has been said that lawyers' profits from tobacco suits have given them a war chest for a further attack on asbestos. One major factor is that under American product liability law almost any company that made a product containing asbestos can be included in a claim, provided the plaintiff can prove it was used where he/she worked. Asbestos litigation has therefore turned into a search for the "solvent bystander". The litigation wave has engulfed firms in the construction and lumber, oil and chemical, and aluminum and steel sectors. Originally, about 300 asbestos mining and production companies were entangled in asbestos litigation; by 2003 several thousand firms were involved across all industrial categories.

Plaintiffs' lawyers have been innovative in finding new defendants, such as hidden insurers and distant manufacturers along the asbestos supply chain. In Mississippi in 2001, six plaintiffs sued 3M, a company that made gas masks that allegedly should have protected them from asbestos dust, and were awarded \$150 million compensation by the court. Some members of the plaintiffs' bar have not hesitated to offer mass-screenings using mobile X-ray vans to diagnose potential asbestos cases; and have been equally quick to file in plaintiff-friendly states such as Mississippi and Texas, where multi-million dollar verdicts are common. For example, in August 2001 a Texas jury awarded over \$55 million to a 47-year-old father of four, who blamed his mesothelioma on the asbestos in a paint manufacturer's joint compound he had used while building homes in California in the 1970s (Worthington, 2003). Thousands of claims have also been filed on behalf of individuals who, although once exposed to asbestos, are healthy and have yet to show any significant asbestos-disease symptoms. These so-called "unimpaired claims" are controversial, even amongst some personal-injury lawyers, who argue that compensation should go first to the seriously ill (for example, those with malignant disease). Yet presently most of the money paid by defendant manufacturers goes to unimpaired

claims. In 2001, the Manville Personal Injury Trust received 70,000 new asbestos claims, only 6% of which related to cancer (Worthington, 2003).

Companies are in a double bind: if they unsuccessfully defend cases, then they can lose and pay millions of dollars (with many similar cases in the pipeline). But settling can also be expensive, because it may encourage more claims, and also drive up costs. Investors in the US have been advised by a leading credit analyst to avoid all companies with any potential asbestos liabilities (*Financial Times*, 15 January 2001). The list of such companies now includes Ford, General Motors and DaimlerChrysler – all targeted for using asbestos in brake linings. There have even been fears that the claims situation could worsen following the destruction of the World Trade Center in New York, where asbestos used in building materials was released throughout Manhattan in the dusty aftermath of September 11th.

Thus, the hopes that the pursuit of victim compensation through the tort system would be an attractive alternative to state-based injury compensation because it provided better payouts, deterrence and corrective justice have not been fulfilled. Compensation remains a lottery for victims, while the courts are clogged with claims and huge amounts of money are siphoned into the pockets of the plaintiffs' bar and defendants' attorneys. But whatever the inadequacies of the tort system, the failings of Chapter 11 in ensuring equitable compensation are equally glaring. Claims are immediately stayed, while lawyers and administrators are paid for restructuring the debts of a company that continues to trade. Many years can elapse while the company is in this position. The RAND Institute for Civil Justice studied 11 major US asbestos defendants and found that the average period from bankruptcy petition to confirmation of a re-organisation plan was 6 years; for three firms it was over 10 years (Hensler et al., 2001, p. 31). Shareholders usually lose their money in Chapter 11, but sick asbestos plaintiffs are often in a worse position and there is usually a long delay before they are paid – sometimes over 10 years (a significant time-scale for mesothelioma, which can kill within a year). Johns-Manville filed for bankruptcy in 1982, the courts approved this claim in 1988, but payment to victims did not resume until 1995. Predictably, claimants experience delay and uncertainty, the amount the company has

to settle claims is often reduced, and future claimants sometimes receive nothing.

The Johns-Manville Chapter 11 experience is instructive. Despite the controversy and publicity generated in the aftermath of this event in 1982 – particularly by the publication of investigative-journalist Paul Brodeur's exposé (Brodeur, 1985) – it has been described as "one of the most underreported financial news events of the latter part of the 20th century" (Bowker, 2003). It took 6 years before the court devised a procedure whereby two trusts – a Personal Injury Trust and a Property Damage Settlement Trust – were created (independent from the company) as a source of payments for asbestos claimants. The Trusts have had a chequered history, with the PI Trust (the larger of the two) accused of poor administration. Castleman (1996, p. 803), in a detailed review of Manville's history, notes that the PI Trust paid \$1.1 billion to settle claims between 1988 and 1994, while running up \$179 million in expenses. The PI Trust soon ran out of money and it is now so drained by the number of claimants that it can only pay five cents in the dollar of each settlement (*Financial Times*, 15 November 2001). In the aftermath of the Chapter 11 reorganization, many existing claimants received sizeable payments, but in a controversial deal future claims were barred. Thus, "the company had gotten what it wanted most – the elimination of future jury awards and a minimal payout required on all future claims" (Bowker, 2003, p. 266). The original company, protected from asbestos claims, has prospered and has current sales of about \$2 billion.

More asbestos bankruptcies look certain to follow, particularly for companies such as Halliburton, Dresser Industries, PPG, and other solvent corporations seeking to escape liability for their acquisition of asbestos companies. A law which permits them to avoid filing for bankruptcy, while obtaining full protection from the bankruptcy courts, remains attractive. Sometimes the subsidiary company will file for bankruptcy and simultaneously file for temporary injunctive relief, prohibiting suits against the non-filing parent. The argument is that this preserves funds for asbestos claimants; though critics allege that this legal legerdemain encourages corporate shell games and therefore reduces compensation. This is particularly so because with each new bankruptcy proceedings there are deadlines, called bar dates, for

the filing of proofs of claim. This demands vigilance, knowledge and quick footwork from claimants, some of whom are already seriously ill.

International Consequences of Chapter 11: The case of Federal Mogul/T&N

Almost all industrial countries are now experiencing a rise in asbestos-related disease (especially cancers). Litigation has therefore become international, reflecting the multinational nature of the asbestos industry. At the start of 2003, the Swiss electrical engineering company ABB announced a \$1.2 billion agreement to settle its asbestos liabilities. These had stemmed from the take-over in 1990 of an American company, Combustion Engineering, which had once used asbestos in its boilers. As part of the settlement, Combustion Engineering filed for Chapter 11 protection in Delaware. Similarly, the Austrian steel company, RHI has also been forced to seek Chapter 11 protection for its acquired US subsidiary companies, which have mounting asbestos liabilities (*Financial Times*, 8 January 2002).

Some of the complexities of Chapter 11 and its international repercussions can be seen by examining the case of Federal Mogul/T&N. Federal Mogul (FM) is a long-established American manufacturer of bearings, pistons, and seals for the automotive market. Based in Southfield, Michigan, it was founded in 1899 and has never made asbestos products. By the mid-1990s, FM had become a vehicle for the ambitions of CEO Dick Snell, who had launched a world-wide expansion plan for the company. This was to boost FM's employees from about 15,000 in 1996 to over 50,000 in 1999 and place the company among the world's top 20 independent automotive suppliers.

Equally dramatic was the company's soaring indebtedness as it bought other businesses. Amongst them was T&N. This company – until it was renamed in the 1980s – was better known as Turner & Newall, formerly the UK's largest asbestos producer and in its heyday one of largest asbestos companies in the world (Johnston and McIvor, 2000; Tweedale, 2001). After the 1970s, T&N had faced massive problems in restructuring, alongside a mushrooming bill for compensating the many workers it had exposed to dust. In the 1990s, T&N had switched its

business to the manufacture of automotive components and a thin veneer of profitability had been restored to its operations. In 1996, the company had set aside £1/2 billion for its asbestos liabilities (including a much publicised insurance package) and declared that the asbestos problem was capped. City financiers remained wary, but in 1997 FM bought T&N for £1.5 billion (\$3 billion). FM's management dismissed the asbestos problem as of little consequence.

By mid-1999, however, FM's dash for growth had stalled. Its revenues has grown to about \$7 billion, but it had nearly \$5 billion in debt. Weak sales and a slowing US economy had combined with the costs of rationalising FM's hasty purchases. But the company's major problem was its new-found asbestos liabilities. By the time of the take-over, T&N had been sued in more than 200,000 personal-injury cases and several hundred property-damage actions; but at the start of 2000, some 60,000 claims were still outstanding and more were arriving daily. This was far more than FM had anticipated, leading some analysts to question whether FM had conducted enough due diligence. FM argued that its belief that T&N's asbestos liabilities had been contained was "reasonable" and blamed the workings of the tort system for its problems (FM/T&N, 2001).

Snell resigned in October 2000 – with a reported \$4.1 million severance and \$422,000 annual pension – triggering rumours of FM's own demise. As its share price plummeted, FM's litigation costs rose from \$89 million in 1998, to \$178 million in 1999, and \$335 million in 2000 (with the company estimating that it would need another \$1 billion by 2004 alone). In 2001, FM filed for Chapter 11 bankruptcy (Butters, 2001).

A familiar picture unfolded for those seeking compensation from FM/T&N: although the company had substantial revenues (\$6 billion a year), all litigation was stayed, with the company claiming that the estimated £8.8 billion of liabilities would soon eclipse its \$10.15 billion assets (Zamoyski, 2001). However, the bankruptcy had some unusual features. T&N's previous involvement with the American market and the fact that FM was an American business, had opened up the company to over 300,000 US asbestos claims (most of them product-liability suits, stemming from gasket and brake companies that had been acquired by FM). It

was these claims that the owners of T&N and FM stated were the reason for them seeking court protection. Ironically, none of these claims involved employees of T&N and many were "unimpaired" claimants. In contrast, in the UK there were only about 400 claims against FM/T&N, and two-thirds of these involved former T&N workers with significant asbestos-related disease. Yet when FM/T&N's former 130 UK companies went into administration on 1 October 2001, all UK asbestos claims also ground to a halt (Gibb, 2001). Through no fault of the UK claimants, resolution of these claims had become inextricably ensnared with the haggling of attorneys and creditors several thousand miles distant.

This injustice raised a storm of protest in the UK from personal-injury lawyers, who characterised the administration order as a "legal device by which the companies can continue to trade while ignoring the urgent needs of the many people who suffer the dreadful effects of asbestos exposure" (Bailey, 2001-2002). The media, victims' groups, and MPs such as John Battle added their criticisms (Battle, 2002; Hansard, 2002). The FM/T&N "scandal" came at a bad time for UK asbestos claimants generally (*British Asbestos Newsletter*, 2001-2002). It roughly coincided with the collapse of asbestos insurers Chester Street Holdings, which itself entered administration. This meant that thousands of victims were threatened with payment of only 5% of the compensation they were owed and with most of them paying their own legal costs. However, the government pressured the Association of British Insurers to provide a rescue package of over £5 million to improve the compensation payments to Chester Street claimants (*Financial Times*, 6 August 2001). More generally, asbestos victims' chances of claiming compensation from companies received a temporary (if protracted setback) when the so-called Fairchild ruling appeared to rule out compensation to anyone who had been exposed by more than one employer.

Before the start of Chapter 11 proceedings, T&N's policy in the UK was to settle actions, providing the case against the company was judged "meritorious". But presently no one knows when compensation will resume from the company, while the withdrawal of compensation already awarded has produced a particularly tragic situation for many. For example, a former T&N worker, Ken Hall, was

awarded a settlement of £70,000 before his death from mesothelioma in 2001, but the offer was withdrawn shortly afterwards (Channel 4 News, 2002). Five American creditors' committees are now involved, with UK lawyers as essentially bystanders. The Americans have made it clear that they see no way of coming to an arrangement with British victims, so that they can be extracted from the morass of US claims. As one personal-injury lawyer put it: "The impression we have is of the relatively small number of English asbestos victims being immersed in a sea of US claims, with the outcome determined by American courts and lawyers" (Pickering and Partners, 2002).

The delay, however, allowed the administrators of T&N in the UK time to use their legal skills creatively. In 2002, they launched an action against Turner and Newall's old insurers, Royal Sun Alliance and a Lloyd's syndicate. T&N's administrators allege that the insurers are liable to pay for claims from workers exposed to asbestos from the 1960s. Royal Sun Alliance and Lloyds are contesting the case, arguing that the policies excluded asbestos-related disease and that, anyway, T&N never disclosed fully the dangers of asbestos. Trial of the first issue (the insurers' liability) began in early 2003 (Stevenson, 2003; Tait and Bolger, 2003): the insurers were found to be liable. This triggered a much longer trial to test RSA's and Lloyd's non-disclosure defence. None of these issues will probably be resolved swiftly, but whatever happens, the lawyers will be paid first.

FM has removed in bankruptcy during 2004. After reorganisation the company will be owned by its creditors, who will issue new shares (with the old shares rendered worthless). The controlling shareholding will go to a trust (effectively the creditors), set up under a provision of the bankruptcy code to pay asbestos claimants. It is the device used by Johns-Manville and is unlikely to result in significant payments to asbestos claimants, either in the US or UK (Butters, 2003). In another move in early 2003, FM announced that it intended to acquire *gratis* Bendix's friction materials division which once made asbestos brakes and was owned by Honeywell. The deal would have involved FM accepting \$2 billion of insurance from Honeywell, in return for FM taking over Honeywell's asbestos liabilities. The absorption of Honeywell's liabilities by a company in Chapter

11 was later shelved after protests from victims' action groups.

Chapter 11: A model for Europe and the UK?

In the UK, the bankruptcy laws – which have been periodically revised in 1883, 1914, 1976, 1986 – have evolved differently to the US (Franks and Torous, 1992). In the UK, there has traditionally been more emphasis (at least as regards personal bankruptcy) on shaming and retribution. However, the influence of Chapter 11 has prompted the UK government to introduce its own version of this rescue procedure, which offers a more lenient approach to corporate insolvency. The 1986 Insolvency Act, based upon some of the recommendations of the 1982 Cork Report, made several changes to the system: it abolished the concept of an act of bankruptcy; introduced automatic discharge for first-time bankrupts after 3 years; and allowed the bankrupt to retain a greater range of their personal assets. Whilst the Cork Report noted the need for bankruptcy proceedings to uphold standards of “commercial morality”, the policy it recommended to deal with bankrupts was to move away from shaming towards the “rehabilitation of the debtor” – reflecting society’s general approach to criminal punishment. This trend has not been without its critics, particularly from the communitarian school of modern social philosophy (Etzioni, 1997).

For corporate entities in the UK, the bankruptcy (or to use the correct term, insolvency) regime is somewhat tougher. Since private court actions by creditors would be unlikely to maximise the value of a debtor’s assets and their equitable distribution, insolvency law adopts a collective approach to realising a debtor-company’s assets. The general principle of UK insolvency law is that of equal distribution to creditors unless preferred classes of creditors (the state or employees) are created. Corporate rescue mechanisms in insolvency law aim at facilitating the survival of the company in order to realise the highest asset value for creditors. In the UK, insolvent companies face either: administrative receivership, administration, voluntary arrangements, creditors’ voluntary liquidation, compulsory liquidation, or the appointment of a provisional liquidator. Usually, the company’s directors are re-

placed by a qualified insolvency practitioner or official receiver. One option under the 1986 Insolvency Act is “administration”. This procedure involves the appointment by court order of an administrator, who attempts to formulate, if possible, a plan for dealing with the company other than by putting it into liquidation that will meet with creditors’ approval. Whilst the company is in administration, the creditors cannot enforce their security claims; and the administrator cannot pay one creditor in preference to others. Meanwhile, the company can continue to trade.

Yet this picture for companies is beginning to change in the UK, with the US model of bankruptcy and insolvency practice (and Chapter 11) increasingly being mooted. Some corporate advisers now are said to recommend that if a company is going to go bust the best place to do it from the management’s perspective is in the US because of the protections afforded by Chapter 11. The US bankruptcy code allows the US courts to take jurisdiction over a company if it has any American assets, even if they are rather tenuously connected to the US. For example, Golden Ocean, a Channel Islands shipping company, with virtually no US assets, established US bankruptcy court jurisdiction through its three bank accounts in Delaware; containing less than \$20,000 in each account (*Financial Times*, 4 February 2002).

Some firms and insolvency practitioners are continuing to lobby for the adoption of the Chapter 11 approach (DTI, 2000). Most recently, Land Rover made this call, after its court battle with the receiver of a manufacturing components supplier, which virtually held it to ransom in return for payments in advance of supply to their Solihull car plant (*Financial Times*, 19 February 2002). Many UK firms obviously find the protection afforded to bankrupts from creditors during Chapter 11 administration an attractive proposition. The DTI, in its consultation document issued prior to drafting the Insolvency Act 2000, stated that “it would be wholly inappropriate to attempt to replicate Chapter 11 in the UK, where the business culture and economic environment are quite different” (DTI, 2000, p. 10). However, a Chapter 11 insolvency procedure in the UK may not be that distant, given the government’s intention to make the law more debtor-friendly.

Some of the most draconian regimes for bankruptcy discharge are still to be found in Europe,

where many long-term restrictions are placed upon insolvent companies and their directors. However, in many European countries and increasingly in many other parts of the world Chapter 11 is looked upon favourably. The power of individual creditors has been curtailed in a new German bankruptcy code, while, in 1996, Sweden introduced a new law heavily influenced by Chapter 11. Chapter 11 type rescue procedures have recently been introduced in Australia, Indonesia, Thailand and Argentina. In the late 1990s, the World Bank set up its Global Insolvency Initiative to formulate a set of principles and guidelines for insolvency systems. The World Bank's recommendations to all countries on corporate insolvency are strongly in favour of rehabilitation regimes similar to those in Chapter 11 (World Bank, 1999). Indeed, the popularity of the Chapter 11 bankruptcy procedure has even influenced thinking in the IMF, a world governance institution. Its vice-president, Anne Krueger, has recently floated the idea that an international Chapter 11 style bankruptcy procedure for governments should be created. This would give the IMF the power to impose a standstill to prevent private-sector creditors suing governments during negotiations over debt restructuring. The procedure would substantially increase debtor governments' powers at the expense of bondholders. Private investors fear that such a procedure would reduce lending to emerging markets, as bondholders anticipate that borrower countries would find it too easy to declare moratoriums on interest payments (*Financial Times*, 29 November 2001).

The growing popularity of Chapter 11 style rehabilitation systems world wide is ironic in view of growing criticism of the code in the US (Delaney, 1998; Hart, 2000). Although our article has not attempted a comprehensive review of the Chapter 11 bankruptcy code, it has revealed a wide range of reservations concerning its operation. Bankruptcy, inevitably, stands revealed as a highly complex economic and social event. Its effects are difficult to quantify and judgement is clouded by conflicting interests and lack of information. Nevertheless, Chapter 11 hardly seems to be a panacea for reinvigorating ailing companies.

Our asbestos case study has confirmed many of these reservations, though it has also highlighted new complexities, both ethical and economic. Part of the problem is the sheer size of the asbestos crisis.

It has been estimated that the number of claims may soon exceed 2.5 million (five times the present level), though this figure itself is dwarfed by the number of Americans exposed to asbestos (possibly 100 million). Estimates of the total costs hovered around \$40 billion in the 1990s, but by 2001 consultants suggested that the final figure may be five-fold (Connon, 2002). Reports commissioned by insurers have calculated that asbestos claims have cost US business \$275 billion and lost 55,000 jobs among companies that have never manufactured asbestos (Stiglitz et al., 2002). This has reenergised efforts by industrialists and insurers to lobby the US government and there have been calls from tort reformists for the creation of a national compensation agreement. Meanwhile, Chapter 11 is defended as a necessary safety-valve to protect industry and workers' jobs. However, it would seem that in many cases Chapter 11 has become a management strategy of choice rather than of necessity.

Unfortunately, much of the asbestos debate is clouded by misinformation and the power of numerous vested interests. Of these, the most powerful are those involved with industry and insurance. Much of the writing on the asbestos "crisis" originates from the financial press, which often subtly presents plaintiffs' lawyers as the villains and companies as the victims (e.g. the series of articles in *Financial Times*, 9 September 2002). It should be remembered that for many years asbestos companies (while they were exposing workers to a hazardous dust) were happy with – and even encouraged – a system of compensation that prevented workers suing for negligence. If the companies and their present workers have suffered, their economic costs are still trivial when compared with the massive social, economic and emotional hardships imposed on asbestos-disease sufferers. Nor, it might be argued, should companies be spared the consequences of knowingly acquiring companies with asbestos liabilities. If Congress is to become involved with asbestos, then amongst the problems it should examine should be the Chapter 11 procedure. As one critic has remarked: "Currently, there is no meaningful oversight of the process, nor any evaluation procedure to determine whether it is working in a fair and equitable manner. Part of that evaluation should include a possible redefinition of Chapter 11 laws so that guilty corporations cannot

escape paying the cleanup costs of the sites they have contaminated" (Bowker, 2003, p. 275).

With the debate over the merits of Chapter 11 far from settled in the land of its birth, it would be disturbing to find it appear one day as a vehicle for all insolvency systems. Certainly, if asbestos is regarded as a litmus test for the procedure, it offers more opportunity for shedding liabilities and lining the pockets of the professional classes (Shaw's "conspiracy against the laity"), than nurturing a prosperous and equitable economy. It may be an irony of our age that the increasing take up of corporate social responsibility as a voluntary commitment is being counteracted by changes in insolvency laws in the direction of licensing greater corporate irresponsibility.

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