Innovative Approaches To Complex Restructurings: Creating A New Chapter For Kaiser Aluminum And USG

Gregory M. Gordon and David G. Heiman

JONES DAY

Gregory M. Gordon

David G. Heiman

Precipitously declining liquidity, significantly underfunded pensions, crippling retiree medical obligations, widespread environmental liabilities and massive numbers of asbestos and tort claims topped the laundry list of complex restructuring issues Kaiser Aluminum Corporation and 25 of its affiliates faced at the time of their February 12, 2002 chapter 11 filings in the United States Bankruptcy Court for the District of Delaware.

In contrast, USG Corporation was struggling with one stifling issue: U.S. Gypsum, a wholly owed subsidiary of USG, was buried in 150,000 personal injury lawsuits stemming from alleged exposure to asbestos-containing products. Overwhelmed by the mounting litigation, USG and 10 of its subsidiaries also looked to Delaware for relief by initiating chapter 11 proceedings on June 25, 2001.

Both Kaiser and USG were faced with potential bet-the-company issues and turned to Jones Day for creative solutions.

At the outset of its chapter 11 filing, Kaiser, which was founded by well-known industrialist Henry J. Kaiser in 1946, was burdened with approximately $4 billion in debt and had insufficient liquidity to meet its impending obligations, including two issuances of senior notes with an aggregate outstanding principal balance of approximately $398 million and an issuance of senior subordinated notes with an outstanding principal balance of $400 million. Kaiser and its affiliates had worldwide operations in all principal aspects of the aluminum industry. Certain of the operations were conducted at overseas facilities owned through five nondebtor, joint venture affiliates in which Kaiser owned less than a 100 percent ownership interest.

Following the stabilization of Kaiser's post-bankruptcy operations, including securing access to a $200 million postpetition revolving credit facility, the company began formulating a strategic business plan. Jones Day assisted Kaiser in implementing that plan, which included the sale of certain of Kaiser's businesses. Jones Day played a key role in the sale of mining and refinery interests in Jamaica, interests in an alumina refinery in Australia and interests in a smelter in Ghana, not to mention a Louisiana refinery and other assets. Foreign joint venture structures, including rights of first refusal and rights of first opportunity held by foreign joint venture partners, created complex issues in some transactions. These sales ultimately generated approximately $700 million in proceeds.

After formulation of the strategic plan, Kaiser and Jones Day focused their efforts on the multifold task of restructuring Kaiser's substantial retiree medical, pension, tort, intercompany and environmental liabilities, types of liabilities that are often considered classic reorganization killers. Restructuring of these liabilities was particularly challenging because of some difficult "chicken and egg" dilemmas presented by the combination of issues.

Kaiser and Jones Day first began the daunting task of addressing the company's legacy liabilities: over $600 million in underfunded pension liabilities and $790 million in retiree medical liabilities. Kaiser had eight separate defined benefit pension plans as well as retiree medical programs, most of which were provided pursuant to collective bargaining agreements with various unions.

After extensive negotiations, Kaiser reached negotiated agreements with the United Steelworkers and four other unions as well as a committee of salaried retirees, which agreements were eventually approved by the bankruptcy court. With respect to retiree medical liabilities, the agreements provided for the termination of all retiree medical plans and the establishment of voluntary employees' beneficiary associations to provide medical benefits to retirees and to be funded by a certain percentage of the equity of reorganized Kaiser and certain cash payments, including payments based on percentages of reorganized Kaiser's after tax profit. The agreements also provided for the termination of certain pension plans for hourly employees and the implementation of replacement pension plans.

The company, however, had to engage in litigation against the Pension Benefit Guaranty Corporation (PBGC) regarding the distress termination of Kaiser's pension plans. The litigation with the PBGC was ultimately resolved in large part pursuant to a comprehensive settlement, resulting in the termination of Kaiser's three largest pension plans (representing over 90 percent of the liability) and the resolution of all the PBGC's administrative and unsecured claims against Kaiser. The settlement permitted the PBGC to continue its appeal to the Third Circuit Court of Appeals regarding the distress termination of certain smaller pension plans. Kaiser prevailed on the distress termination issues in the bankruptcy court and the district court, and the Third Circuit recently affirmed the lower court decisions. The decisions have set a significant precedent regarding the standards for distress termination of multiple pension plans.

Due to the nature of its operations, Kaiser also faced significant environmental liabilities. During the course of the bankruptcy cases, Kaiser, with Jones Day's assistance, entered into numerous consent decrees, including a multi-site consent decree with certain federal agencies and states that resolved more than $727 million of environmental claims relating to 66 sites.

Another set of obstacles that had to be overcome was the resolution of billions of dollars in intercompany claims among the debtors. Threatened litigation over issues relating to the intercompany claims jeopardized the retiree medical and pension settlements, as well as the reorganization as a whole. With Jones Day's assistance, after protracted negotiations with the creditors' committee, the company successfully reached a complex global settlement of the intercompany claims that involved cash payments, offset of claims, releases and permission to substantively consolidate certain Kaiser entities. The intercompany claims settlement, once approved by the bankruptcy court, would enable the Kaiser subsidiaries that held most of the joint venture interests, which were at that time in the process of being sold as the strategic plan contemplated, to proceed with separate plans of liquidation without awaiting the formulation and confirmation of a plan of reorganization for the remaining Kaiser entities. Because of this proposed separation of the Kaiser entities, the asbestos claimants' committee and the bankruptcy court-appointed legal representatives for future asbestos and other tort claimants each filed an objection to the intercompany claims settlement. Those objections were ultimately resolved by an agreement among all principal constituencies on a plan of reorganization term sheet setting forth, among other things, the parameters for the treatment of the various tort claims and future demands under any plan of reorganization for the reorganizing Kaiser entities.

The tort claims that had to be addressed included not only asbestos claims and future demands – there were more than 100,000 pending asbestos-related lawsuits against Kaiser when the chapter 11 cases were filed – but also a significant number of non-asbestos tort claims and future demands, including claims relating to alleged injuries caused by exposure to silica, coal-tar-pitch volatiles and excess occupational noise. The plan resolved each of these categories of tort claims through (a) the creation of trusts funded by a cash payment of $13 million, 6.4 percent of the equity in the reorganized company (plus 100 percent of the stock of a subsidiary with limited assets) and rights to insurance proceeds and (b) the implementation of channeling injunctions permanently directing these tort claims and future demands from Kaiser to the trusts. The primary source of funding for the trusts consists of the proceeds of insurance coverage settlements that Kaiser entered into with its insurers prior to the plan's effective date, which total more than $1.2 billion.

Meanwhile, USG was dealing with asbestos personal injury litigation of its own. Since the inception of its chapter 11 filings, the amount of USG's present and future asbestos liabilities had been the subject of significant dispute in the bankruptcy court and the district court. The strategy employed in USG's chapter 11 case was based on the parallel tracks of staying all non-bankruptcy litigation, seeking an estimation of its liability via litigation in the bankruptcy court, pursuing federal legislation that would limit its liability to a fair and reasonable amount and, under all of those circumstances, seeking a fair and just settlement that would protect the interests of all creditor and shareholder constituents. The debtors and Jones Day persistently maintained and implemented this multi-track strategy over the five-year duration of the case, leading to unprecedented results for all stakeholders.

Specifically, in December 2005, in the midst of years of litigation, Jones Day and USG met with the asbestos personal injury committee to determine whether a consensual resolution of the reorganization cases could be reached. In late January 2006, after extensive negotiations, an agreement with the asbestos personal injury committee and the asbestos personal injury futures representative was reached to resolve all asbestos personal injury claims. The agreement, which was implemented through the plan and enabled USG to preserve the interests of its stockholders, entailed the payment of approximately $4 billion to a personal injury trust under section 524(g) of the Bankruptcy Code, and channeled all of the present and future asbestos personal injury claims against USG and the other USG companies into the trust, which would be responsible for administering and paying those claims.

The asbestos litigation was settled in large part because USG was able to effectively grow as a company even though it was in bankruptcy. Working with Jones Day, USG was able to insulate itself from the potential negative effects of bankruptcy and remain focused on its business operations. Warren Buffet commented to the *Wall Street Journal* in February that "it's the most successful managerial performance in bankruptcy that I've ever seen."

The settlement was funded, in part, by a $1.8 billion rights offering to existing shareholders backstopped by Warren Buffet's Berkshire Hathaway Inc. The rights offering was the largest of its kind in the history of chapter 11 cases. Additionally, Jones Day assisted USG in formulating other noteworthy deals during the cases, including obtaining a $2.8 billion exit financing facility.

Typically, investors in a company that has filed bankruptcy watch in shock as their stock plummets to pennies. Should the company emerge successfully, it almost always issues new stock and cancels the old, wiping out the entire equity of the previous shareholders. The successful resolution of USG's chapter 11 cases is historic in the context of asbestos bankruptcy cases, as no prior asbestos-driven case has preserved such meaningful value for equity. Further, USG's claimants will be compensated and their banks, bondholders and suppliers will be repaid in full – 100 cents on the dollar, with interest.

After the successful resolution of their liabilities, both Kaiser and USG received overwhelming support for their respective plans of reorganization. The plan of reorganization in Kaiser was accepted by all classes of creditors entitled to vote by more than a 90 percent margin in each class, and the plan of reorganization in USG was approved by more than 99 percent of the asbestos personal injury claimants voting.

Thereafter, both companies successfully completed the chapter 11 process. On July 6, 2006, Kaiser and 20 of its subsidiaries emerged from chapter 11 protection virtually debt-free, with a strong capital structure, substantial liquidity and streamlined business operations that are considered first-in-class in the aluminum industry. USG and its subsidiaries, with their existing stock intact, emerged from chapter 11 on June 20, 2006. Of the several major asbestos chapter 11 cases pending in Delaware, Kaiser and USG are the first two companies to emerge from bankruptcy.

***Gregory M. Gordon** is a Partner in the Dallas office of Jones Day and was lead counsel in the Kaiser Aluminum chapter 11 cases. **David G. Heiman** is a Partner in the Cleveland office of Jones Day and was lead counsel in the USG chapter 11 cases. Both represent debtors, creditors' committees, financial institutions and other parties in chapter 11 proceedings, out-of-court restructurings and commercial litigation matters.*

Please email the authors at gmgordon@jonesday.com or dgheiman@jonesday.com with questions about this article.