IADC COMMITTEE NEWSLETTER

TOXIC AND HAZARDOUS SUBSTANCES LITIGATION

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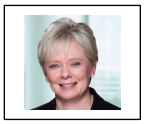
IN THIS ISSUE

In February, the New Jersey Bankruptcy Court determined that Johnson & Johnson did not act in bad faith when it utilized a Texas divisive merger statute commonly known as the "Texas Two-Step" in an attempt to resolve its cosmetic talc liabilities associated with its Johnson's baby powder product. Subject to much criticism by the plaintiffs' bar and in the media, it remains to be seen whether this decision will survive an expected appeal, whether it will spur similar bankruptcy petitions by other companies, or whether Congress will attempt to limit its use in the future.

New Jersey Bankruptcy Court Rules that Johnson & Johnson's Texas Two-Step was not a Bad Faith Filing

ABOUT THE AUTHORS



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Member participation is the focus and objective of the Toxic and Hazardous Substances Litigation Committee, whether through a monthly newsletter, committee Community page, e-mail inquiries and contacts regarding tactics, experts and the business of the committee, semi-annual committee meetings to discuss issues and business, Journal articles and other scholarship, our outreach program to welcome new members and members waiting to get involved, or networking and CLE presentations significant to the experienced trial lawyer defending toxic tort and related cases. Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact:

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Johnson & Johnson ("J&J"), one of the world's most well-known pharmaceutical companies, got its start in 1886 when Robert Wood Johnson, along with his brothers James Wood Johnson and Edward Mead Johnson, formed a company to create surgical dressings. Following some early success, in 1894 J&J expanded to create a line of products directed towards expectant mothers and their new babies. Two products were released: maternity kits and baby powder.[1] That baby powder, still available today, has become so ubiquitous it is likely that you recall seeing a bottle of Johnson's baby powder in your home at some point in your life.

More recently, J&J has been in the news relating to more than 38,000 lawsuits claiming that asbestos-contaminated cosmetic talc used in its baby powder resulted in thousands of consumers developing ovarian cancer and mesothelioma. In Fall 2021, J&J, through a series of intercompany transactions between a number of its affiliates, diverged its talc-based liabilities into a company called LTL Management LLC ("LTL" or "" Debtor"), a newly created subsidiary. Then on October 14, 2021, LTL filed a petition in the United States Bankruptcy Court for the Western District of North Carolina seeking relief under chapter 11 of the United States Bankruptcy Code.[2] The case was subsequently transferred to the District of New Jersey and has been assigned to Judge Michael B. Kaplan.

A number of claimants, including the Official Committee of Talc Claimants (collectively "Claimants"), filed motions seeking to dismiss LTL's bankruptcy petition pursuant to 11 U.S.C. § 1112(b), urging that the case was not filed in "good faith."[3] The position of the Claimants was that "the divisional merger under the Texas Business Corporation Act[4] widely referred to as the 'Texas Two-Step' []—was intended to force talc claimants to face delay and to secure a 'bankruptcy discount'; in [Claimants'] words, 'an obvious legal maneuver to impose an unfavorable settlement dynamic on talc victims.'"[5] Conversely, LTL had "a far more positive view of the chapter 11 foundation and its purposes: to produce an equitable resolution of both current and future talc claims by means of a settlement trust, established pursuant to § 105 or § 524(g), that can promptly, efficiently, and fairly compensate claimants."[6]

On February 14, 2022, Judge Kaplan commenced a five-day trial to address these motions, along with a related preliminary injunction motion filed by LTL seeking to extend a stay of all cosmetic talc claims

[1] https://www.thestreet.com/personal-finance/history-of-johnson-and-johnson(visited March 11, 2022).

[2] *In re LTL Mgmt., LLC*, Case No. 21-30589 (Bankr. W.D.N.C. filed Oct. 14, 2021).

[3] *In re LTL Mgmt., LLC*, Case No. 21-30589, 2022 WL 596617, at *1 (Bankr. D.N.J. Feb. 25, 2022).

[4] Tex. Bus. Orgs. Code Ann. § 1.002(55)(A) (2019).

[5] *Id.* at *4.

[6] *Id.* at *5.

litigation against J&J and other related non-debtor third-parties.[7]

During the trial, Judge Kaplan considered testimony from fact and expert witnesses from both sides. In the end, the Judge denied the Claimants' motions to dismiss and granted LTL's preliminary injunction motion to extend the stay. After laying out the general standard under which the Motions were to be considered, the Judge determined "that the general focus must be '(1) whether the petition serves a valid bankruptcy purpose and (2) whether the petition is filed merely to obtain a tactical litigation advantage.'"[8]

The petition serves a valid bankruptcy purpose:

On the first issue Judge Kaplan squarely sided with Debtor that the petition served a valid bankruptcy purpose. He noted the significant docket of pending claims and the anticipated billions of dollars in liabilities and defense costs, stating that "Debtor's efforts to address the financially draining mass tort exposure through a bankruptcy is wholly consistent with the aims of the Bankruptcy Code."[9] The Court went on to state that:

> Determining whether Debtor is pursuing a valid bankruptcy purpose through this chapter 11 proceeding also requires the Court to examine a far more difficult issue—whether there is available to Debtor and the tort claimants a more beneficial and equitable path toward resolving Debtor's ongoing talc-related liabilities. . . . [T]his Court holds a strong conviction that the bankruptcy court is the optimal venue for redressing the harms of both present and future talc claimants in this case—ensuring a meaningful, timely, and equitable recovery.[10]

While Judge Kaplan acknowledged the passion and commitment of the Claimants and their counsel, "the Court simply cannot accept the premise that continued litigation in state and federal courts serves best the interest of their constituency."[11] Instead, the Judge stated that

> the bankruptcy system, through use of a § 524(g) trust, will "provide all claimants—including future claimants who have yet to institute litigation—with an efficient means through which to equitably resolve their claims." A settlement trust, with proper oversight and funding, can best serve the needs of Debtor and talc claimants alike.[12]

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[7] *Id.* at *4; *see also In re LTL Mgmt., LLC*, Case No. 21-30589, Adv. Pro No. 21-03032, 2022 WL 586161 (Bankr. D.N.J. Feb. 25, 2022).

[8] *Id.* at *5 (quoting *15375 Mem'l Corp. v. BEPCO, L.P. (In re 15375 Mem'l Corp.)*, 589 F.3d 605, 618 (3d Cir. 2009)).

[9] *Id.* at *8.

[10] *Id.* at *9.

[11] *Id.* at *10.

[12] *Id.* at *14 (quoting *In re Bestwall LLC*, 606 B.R. 243, 257 (Bankr. W.D.N.C. 2019)).

While the Court acknowledged Claimants' argument that Debtor acted in bad faith through its actions immediately prior to filing its chapter 11 petition, the Court rejected the notion that such actions were done as part of some scheme to defraud its creditors. Instead, the Court stated

> it is unsurprising that J&J and Old JJCI management would seek to limit exposure to present and future claims. Their fiduciary obligations and corporate responsibilities demand such actions. Nonetheless, merely seeking to limit liabilities, standing alone, does not demonstrate "bad faith" for purposes of filing under chapter 11. If that were so, nary a debtor would meet the "good faith' requirements. Rather, the Court finds this chapter 11 is being used, not to escape liability, but to bring about accountability and certainty.
>
> The record before the Court does not reflect assets that have been ring-fenced, concealed, or removed. Neither J&J nor New JJCI (nor any J&J affiliate for that matter) are to be released from liability, or their assets placed out of reach of creditors, absent a negotiated settlement under a plan in which J&J's and New JJCI's roles and funding contributions warrant a release as a matter of both law and fact.[13]

Debtor's petition was not filed to obtain an unfair tactical advantage:

With regards to the second issue to be decided by the Court, Judge Kaplan focused on the crux of Claimants argument that the 2021 corporate restructuring enacted by J&J and its affiliates using the Texas divisive merger statute hinds or outright blocks Claimants from accessing J&J's business assets. Despite what the Court termed "a barrage of academic and media criticism," it concluded "that there have been no improprieties or failures to comply with the Texas statute's requirements for implementation, and that the interests of present and future talc litigation creditors have not been prejudiced."[14] The Court went on to note that

> The decision to seek resolution of the present and future talc claims within the bankruptcy system, through a § 524(g) asbestos settlement trust in lieu of continued state court litigation, is consistent with congressional objectives dating back to implementation of the § 524 asbestos provisions, which codified the approach taken in *In re Johns-Manville*. Congress has not made significant modifications to the statute, so we must assume that such mass tort resolutions—at least as to asbestos claims—are consistent with public policy.[15]

[13] *Id.* at *14.
[14] *Id.* at *15.
[15] *Id.* at *22 (citing *In re Johns-Manville*, 36 B.R. 727 (Bankr. S.D.N.Y 1984)).

The Court concluded that Debtor did not pursue a corporate restructuring and subsequent bankruptcy solely to gain a tactical litigation advantage. Instead, the Court determined that "Debtor seeks to employ the tools provided by Congress under the Bankruptcy Code (the automatic stay and § 105 or § 524(g) trust) to attain a bankruptcy resolution of its mass tort liabilities. Without more, merely availing itself of chapter 11 tools does not constitute an improper litigation tactic".[16]

As further assurance that Debtor's petition would not be a tactical advantage, the Court noted that resolving these mass-tort liabilities through a § 524(g) will still require Debtor to meet a confirmation hurdle:

> Moreover, remedial creditor actions addressing the pre-petition divisive merger and restructuring remain available for creditors to pursue, if necessary. It is appropriate to note that the true leverage remains where Congress allocated such leverage, with the tort claimants who must approve of any plan employing a § 524(g) trust by a 75% super majority. In filing this chapter 11, Debtor faces a risk that good-faith negotiations will not produce the consensus necessary to confirm a plan . . . .[17]

The stay of all cosmetic talc claims litigation against J&J and other related non-debtor third-parties shall remain in effect:

As mentioned above, the five-day trial also addressed a preliminary injunction motion filed by Debtor that sought to extend a stay of all cosmetic talc claims litigation against J&J and other related non-debtor third-parties pursuant to §§ 105 and 362 of the Bankruptcy Code. A temporary stay was previously entered by the North Carolina Bankruptcy Court prior to transferring the case to New Jersey.[18] In deciding to extend the stay, Judge Kaplan concluded that

> "unusual circumstances" are present warranting an extension of the automatic stay to the Protected Parties under § 362(a)(1) and (3). To the extent § 362(a) does not serve as an independent basis for extension of the stay to nondebtor parties, the Court determines that a preliminary injunction under § 105(a) extending the automatic stay is appropriate.[19] However, the extension of the stay was not without limits. The Court held that the stay would be revisited in 120 days.

Conclusion:

While the Texas Two Step has previously been successfully utilized before, this case is the first time it has been approved in a court outside of North Carolina. It remains to be

[16] *Id.* (citing *In re Am. Cap. Equip., LLC*, 296 F. App'x. 270, 274 (3d Cir. 2008)).
[17] *Id.* at *14.
[18] *In re LTL Mgmt., LLC*, Case No. 21-30589, Adv. Pro No. 21-03032, 2022 WL 586161 at *2.
[19] *Id.* at *21.

seen whether its approval in New Jersey is a sign that other bankruptcy courts around the country will follow suit.

In addition, because LTL's bankruptcy was met with such harsh criticism by the plaintiffs' bar and the media, it is assured that this is not the last that will be heard about this case. This expectation was also appreciated by Judge Kaplan as he said, "[i]n ruling today, however, this Court considers only the facts and applicable law relevant to this case, and this case only, and there is no expectation that this decision will be the final word on the matters."[20] It can almost certainly be expected that appeals will result from Judge Kaplan's rulings. It remains to be seen how the Court of Appeals will react and whether legislative action will be taken by Congress to close the Texas Two Step legal loophole.

[20] *In re LTL Mgmt., LLC*, Case No. 21-30589, 2022 WL 596617, at *6.

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