



## Toxic Tort

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# The Dismissal of Johnson & Johnson's Bankruptcy Petition and the Potential Impacts on Toxic Tort Defendants

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On January 30, 2023, the Third Circuit Court of Appeals released its decision overturning the Bankruptcy Court for the District of New Jersey's denial of Talc Claimant's Motion to Dismiss Johnson & Johnson's (J&J) Chapter 11 Bankruptcy Petition. This decision outright dismissed J&J's Bankruptcy Petition, lifting the stay of litigation for tens of thousands of talc cases.

J&J owns a subsidiary known as Johnson & Johnson Consumer, Inc. (referred to as "Old Consumer" in the decision). This subsidiary is responsible for the products that are the subject of talc litigation against J&J. The Third Circuit noted that over 38,000 ovarian cancer cases and over 400 mesothelioma cases were pending against J&J at the time of the filing of the Bankruptcy Petition. To combat mounting litigation costs, J&J restructured Old Consumer into two separate entities. LTL Management, LLC was designed as a subsidiary of Old Consumer that would hold liabilities, while Johnson & Johnson Consumer, Inc. (now known as New Consumer) would continue to hold the assets. The Court of Appeals noted that LTL Management's entire purpose was to file for bankruptcy in an effort to discharge costs of litigation. On October 14, 2021, LTL Management filed its Chapter 11 Bankruptcy Petition with the Bankruptcy Court for the Western District of North Carolina. The matter was later transferred to the Bankruptcy Court for the District of New Jersey, which led to the appeal being heard by the Third Circuit Court of Appeals. In filing this Bankruptcy Petition, LTL Management obtained an automatic stay of litigation for all pending cases against it, which constituted the majority of J&J's pending talc cases. An entity known as the Official Committee of Talc Claimants appeared as an interested party to LTL Management's Petition and filed a Motion to Dismiss under §1112(b) of the Bankruptcy Code, arguing that LTL Management filed its petition in bad faith. In February of 2022, the New Jersey Bankruptcy Court heard arguments on Talc Claimant's motion and denied the Motion to Dismiss. Since October 14, 2021, there has been a continued stay of litigation in place for LTL Management, essentially blocking talc claims against J&J.

The Talc Claimants appealed the denial of their Motion to Dismiss, and the case was heard by the Third Circuit Court of Appeals. In ruling on the good faith of LTL Management's Bankruptcy Petition, the Court looked at the financial condition of the LTL Management, and found that LTL Management was not in financial distress as contemplated by Chapter 11. The appellate court's basis for reversal of the Bankruptcy Court's decision included, among other things, the backstop provided to LTL Management by J&J. The appellate court also rejected the Bankruptcy Court's finding that even if good faith did not exist, unusual circumstances justified a denial of Talc Claimants' motion to dismiss. The appellate court found that there was no reasonable justification that validates the missing requirement of financial distress and reversed the Bankruptcy Court's denial on those grounds as well.

This case's effect on the strategy employed by J&J as well as other toxic tort defendants, commonly referred to as the "Texas Two-Step," is unclear at this time. The Fourth Circuit cases involving Georgia Pacific (*See In re Bestwall, LLC*, 3:20-cv-105-RJC, 2022 WL 68763 (Bankr. W.D. N.C. January 6, 2022)) and Trane (*See In re Aldrich Pump LLC*, No. 20-30608, 2021 WL 3729335 (Bankr. W.D. N.C. August 23, 2021)) help to support a precedent of litigating liabilities

for past products through the bankruptcy court. Other circuits remain undecided. The Seventh Circuit is currently considering 3M's bankruptcy and it is unknown what decision it will render. See *In re Aearo Technologies, LLC*, 642 B.R. 891, 2022 WL 3746537 (Bankr. S.D. Ind. August 26, 2022). It does not appear that any other circuits have ruled on the appropriateness of creating and funding a subsidiary in order to seek Chapter 11 protection.

At the time this article was written, J&J represented that it would pursue an appeal of this decision to the United States Supreme Court. While the Third Circuit decision seems to create a circuit split, the decision itself does not call into question the Fourth Circuit's rulings on the debtors' strategy as a whole, and does not render these bankruptcies as inherently filed in bad faith. Instead, it clarifies that the decision regarding the "good faith" of these bankruptcy petitions hinges on the financial condition of the entities that file them. While this appears to be a nuanced ruling tailored specifically to the J&J case, the truth is the "Two-Step" strategy is mainly employed by companies that continue to generate products that are still regularly used by consumers. The point of the strategy is to limit liability, to the extent that such liability exists, to prior product lines and to protect the image and sustainability of companies that continue to operate in the stream of commerce. These companies will naturally financially backstop the entities that carry the liability burdens, and thus, these entities will never truly be in financial distress. This, in conjunction with the Court's calculations of potential future liability, suggest the Court's disdain for implementing a liability limiting bankruptcy strategy as J&J did.

The Third Circuit's decision may avoid an explicit circuit split on the issue, but its attitude toward the spirit of strategy suggests that it would not rule in favor of a future bankruptcy petition any time soon. Whether this case is ripe for Supreme Court review may not hinge on this case, but mostly likely will depend on the decision rendered in the 3M case, which may take a more blatant stance against the strategy as a whole, instead of couching the decision as a fact or case specific one.

This case also establishes a favorable jurisdiction for toxic tort claimants in the Third Circuit. The Third Circuit made it clear that it would not accept the Fourth Circuit's stricter standard for dismissing bankruptcy cases for lack of good faith, which requires two factors: "subjective bad faith" and "objective futility of any possible reorganization." The Third Circuit only examined the bad faith component and did not require objectors to show that the corporation could not reorganize. Thus, a potential impact of this case is that other companies wishing to partition liability may find themselves defending their petition in the Third Circuit.

Only time will tell if this strategy has a lasting presence in the toxic tort realm. One negative decision will not deter other companies from employing the "Two Step" strategy, but it could be a signal for what is to come. Other jurisdictions may follow the Third Circuit in ruling against these petitions, or this issue (or this case in particular) may be decided by the Supreme Court. Until the law is settled, companies can anticipate battling it out in the appellate courts of their respective jurisdictions, as it appears unlikely that toxic tort litigants will accept these bankruptcy filings without challenge.

Between the time of writing this article and its publishing, LTL Management has refiled for bankruptcy in New Jersey, this time backstopping the bankruptcy trust with a specific dollar amount. While \$8.9 billion represents a substantial amount of money, it pales in comparison to the unlimited amount that J&J had pledged to pay toxic tort claims. By setting a firm amount for backstopping the claim, J&J hopes to address the Third Circuit's concern that LTL Management was not in financial distress. In an ironic turn of events, the Third Circuit's decision essentially reduced the amount made available to the talc claimants, as instead of the full faith and credit of J&J backing the trust, it is now limited to a limited amount of \$8.9 billion. Not surprisingly, this has created a whole new dispute between certain Plaintiff's attorneys and J&J, most of whom will likely move to dismiss and challenge the bankruptcy filing again. Only time will tell whether this second attempt will be more successful for J&J, but given J&J's change to the structure of the



trust, it will demonstrate the redlines of the Third Circuit, or force its hand in banning the “Two-Step” approach all together.

The Third Circuit’s ruling calls into question the effectiveness of implementing a bankruptcy strategy to settle toxic tort claims. At the very least, this will continue to be a heavily litigated issue, and the ability to use this strategy will more than likely than not be an issue for the Supreme Court. The result of the second filing will inform the limits of the “Two-Step” strategy, specifics such as the amount of money needed to backstop the trust, the disconnection between the main and subordinate entities, and ultimately, whether this strategy is more or less effective for companies facing toxic tort claims.

### About the Author

**Robert J. Jellen** is an associate in the Edwardsville office of *Heyl, Royster Voelker & Allen, P.C.* where he focuses his practice in civil litigation. Mr. Jellen primarily practices in toxic tort, representing a variety of clients in asbestos litigation. He also represents a major insurance company in insurance coverage disputes and has represented creditors in bankruptcy courts in Illinois. Mr. Jellen received his B.S. and B.A. from Southeast Missouri State University and his J.D. from Southern Illinois University Carbondale.

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