Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT® NOVEMBER-DECEMBER 2023

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 19 NUMBER 8 November-December 2023

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call or email:

Ryan D. Kearns, J.D., at 513.257.9021
Email: ..... ryan.kearns@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3385
Fax Number . . . . . (800) 828-8341
Customer Service Website . . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call

Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2023)

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2023–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

Pratt's Journal of Bankruptcy Law is published eight times a year by Matthew Bender & Company, Inc. For customer support, please contact LexisNexis Matthew Bender, 9443 Springboro Pike, Miamisburg, OH 45342 or call Customer Support at 1-800-833-9844. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway Suite 18R, Floral Park, New York 11005, smeyerowitz@meyerowitzcommunications.com, 631.291.5541. Material for publication is welcomed—articles, decisions, or other items of interest to lawyers and law firms, in-house counsel, government lawyers, senior business executives, and anyone interested in privacy and cybersecurity related issues and legal developments. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 230 Park Ave. 7th Floor, New York NY 10169.

LTL's Second Attempt at Bankruptcy Goes Up in Smoke

By NallyAnn Scaturro*

In this article, the author first explains the good faith and financial distress requirements needed to validly file a bankruptcy petition. She then discusses the importance of the finding by the U.S. Court of Appeals for the Third Circuit that financial distress must be imminent because of the significance of the pre-bankruptcy civil right to a jury trial. The author concludes by exploring what that means for the future for mass torts litigation.

The original 2021 corporate restructuring project from LTL Management, LLC (LTL) was named Project Plato.[1] In the *Republic*, Plato examines the meaning of justice and creates a model of what he sees to be an ideal society led by an enlightened philosopher king.[2] Its brand of ethical philosophy is "consequentialism," meaning that actions that bring about more benefit than harm are "good" and actions that cause more harm than benefit are "bad."[3] Interestingly, Plato's *Republic* has been employed by the powerful in order to promote rule of the elite, oppose democracy, and protect the existing class system.[4]

The U.S. Bankruptcy Court of the District of New Jersey delighted in this naming and though it agreed with the U.S. Court of Appeals for the Third Circuit that LTL did not meet the requirement of financial distress, it focused much of its decision on whether LTL's Chapter 11 filing might have produced a just and right result that would have warranted its use of the bankruptcy system.[5]

However, in our democratic nation, governed and protected by the U.S. Constitution, plaintiffs are entitled to have even their civil disputes heard by a

---

* NallyAnn Scaturro is an associate attorney in the Mass Torts and Product Liability group based in the New York office at Sullivan Papain Block McGrath Coffinas & Cannavo P.C. She may be contacted at nscaturro@triallaw1.com.

1 In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

2 Plato, The Republic 443-444, Book 4 (c. 375 BCE). With appreciation to Dr. Suzanne Fournier and Dr. Stephen J. Lynch, former chairs of the Liberal Arts Honors Program at Providence College, where I first read Plato in our core class: The Development of Western Civilization.

3 Id.

4 See Urmila Sharma, Western Political Thought 66-67 (1998); see also Ray Moseley, Mussolini: The Last 600 Days of Il Duce 34 (2004) (Italian Dictator Benito Mussolini often read Plato's Republic for inspiration and used many of its ideals to promote fascism).

5 In re LTL Mgmt., LLC., supra note 1.

jury of their peers – a right safeguarded by the Seventh Amendment. The importance of the right to a civil jury cannot be overstated because it was purposely designed to defend the individual against the abuses of more powerful and wealthy citizens.[6] As such, this fundamental right is only to be disrupted in limited circumstances, including when a bankruptcy petition is filed in good faith by a financially distressed debtor.

While the court posited that the imminence requirement of financial distress permitted a business to take action in declaring bankruptcy only when flames were already present rather than at the first sign of smoke, a corporation's preference to preserve value for shareholders does not entitle it to seek shelter in the safe harbor of the bankruptcy system and disrupt mass tort plaintiffs' right to have their claims heard by a jury of their peers.

BACKGROUND

On January 30, 2023, the Third Circuit dismissed LTL's bankruptcy petition finding it was not filed in good faith due to Debtor's lack of financial distress.[7] Thus LTL could not avail itself of the bankruptcy system to shield itself from liabilities and deny mass tort litigants the chance to prove to a jury of their peers injuries claimed to be caused by its consumer product, Johnson & Johnson's Baby Powder, when it had the financial capacity to meet these claims in the form of a $65 billion funding agreement backed by its parent company Johnson & Johnson (J&J).[8]

In its decision, the Third Circuit upheld the central tenant of the U. S. Bankruptcy Code: providing debtors an opportunity to deal with the reorganization of a distressed enterprise.[9] Additionally, the Third Circuit declared that financial distress must be imminent in order for a petition to serve a valid bankruptcy purpose supporting good faith because "the mere attenuated

---

[6] 3 William Blackstone, Commentaries at 380.

[7] In re LTL Mgmt., LLC, 64 F.4th 84 (3d Cir. 2023).

[8] For a more comprehensive discussion of this decision see NallyAnn Scaturro, Third Circuit Court of Appeals Steps Away from The Texas Two Step, 19 J. Bankruptcy Law 118-123 (2023).

[9] SGL Carbon, 200 F.3d at 166 (3d Cir. 1999) (quoting S. Rep. No. 95-989, at 9, reprinted in 1978 U.S.C.C.A.N. 5787, 5795); see also Cedar Shore Resort, Inc v. Mueller (In re Cedar Shore Resort, Inc.), 235 F.3d 375, 381 (8th Cir. 2000) ("Congress designed Chapter 11 to give those businesses teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade contractual or other liability.").

possibility that talc litigation may require [LTL] to file for bankruptcy in the future does not establish its good faith as of its petition date."[10]

The order officially dismissing LTL's initial bankruptcy case was entered April 4, 2023.[11] Less than three hours later LTL filed for Chapter 11 protection for a second time armed with a new funding agreement entitling it to a funding backstop with a value approaching $30 billion, and a $8.9 billion settlement trust fund.[12]

On July 28, 2023, the U.S. Bankruptcy Court for the District of New Jersey dismissed LTL's second Chapter 11 petition finding LTL was not in financial distress when it filed for bankruptcy under the standards employed by the Third Circuit and thus could not satisfy the good faith requirement of the Bankruptcy Code.[13] The court did, however, question the wisdom of the imminence component of financial distress necessary for a corporation to avail itself of the bankruptcy system, stating that the Third Circuit standard requires fire when smoke should be sufficient.

This article first explains the good faith and financial distress requirements needed to validly file a bankruptcy petition. It then discusses the importance of the Third Circuit's finding that financial distress must be imminent because of the significance of the pre-bankruptcy civil right to a jury trial. It concludes by exploring what the decision means for the future for mass torts litigation.

GOOD FAITH REQUIREMENT GENERALLY

The good faith requirement is vitally important to maintaining the equitable nature of bankruptcy and the underlying purposes of Chapter 11 of the Bankruptcy Code.[14] A Chapter 11 petition is subject to dismissal for cause under 11 U.S.C. § 1112(b) unless it is filed in good faith.[15] A petition is filed in good faith if it (i) serves a valid bankruptcy purpose, and (ii) is not filed merely to obtain a tactical litigation advantage.[16] It is well-established in the

---

[10] In re LTL Mgmt., LLC, 64 F.4th 84 at 102 (3d Cir. 2023).

[11] In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

[12] Id.

[13] Id.

[14] Barclays-Am./Bus. Credit, Inc. v. Radio WBHP, Inc. (In re Dixie Broad., Inc., 871 F.2d 1023, 1027-28 (11th Cir. 1989).

[15] In re SGL Carbon Corp., 200 F.3d 154, 162 (3d Cir. 1999).

[16] See In re LTL Mgmt., LLC, 64 F.4th at 100.

Third Circuit that "good faith necessarily requires some degree of financial distress on the part of the debtor."[17]

Additionally, as recently articulated by the Third Circuit "financial distress must not only be apparent, but it must be immediate enough to justify a filing."[18] The Third Circuit noted that the finding of imminent financial distress is necessary because bankruptcy significantly disrupts creditors' existing claims against a debtor by vesting Chapter 11 petitioners with considerable powers, including the automatic stay, the exclusive right to propose a reorganization plan, and the discharge of debts, that can impose significant hardship on particular creditors, such as denying tort claimants the opportunity to prove to a jury of their peers injuries claimed to be caused by a consumer product.[19]

IMMINENCE OF FINANCIAL DISTRESS

Although the U.S. Bankruptcy Court for the District of New Jersey dismissed the petition after finding a lack of good faith it disagreed with the wisdom of the Third Circuit's ruling requiring imminent financial distress. The court noted:

> One can view the Third Circuit's ruling as being somewhat at odds with a pro-active approach to trouble. When one smells smoke, the wise course of action is to get out of the house and call for help. However, as it stands now, in gauging financial distress, observing smoke may not be enough – one must see flames.[20]

Along this same vein, the court concluded, "In sum, this Court smells smoke, but does not see the fire. Therefore, the emphasis on certainty and immediacy of financial distress closes the door of chapter 11 to LTL at this juncture."[21] This dramatic fire imagery employed by the court, however, dismisses the overall purpose of the Bankruptcy Code: to give those businesses teetering on

---

[17] In re Integrated Telecom Express, Inc., 384 F.3d 108, 121 (3d Cir. 2004); see also In re LTL Mgmt., LLC, 64 F.4th at 101 ("Our precedents show a debtor who does not suffer from financial distress cannot demonstrate its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith").

[18] See In re LTL Mgmt., LLC, 64 F.4th at 102.

[19] Id. at 103.

[20] In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

[21] Id.

the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again.[22]

Additionally, it should be clarified, in keeping with the fire motif, the smoke in this instance allegedly signifying financial distress is more akin to the type created by a smoke machine than smoke from genuine burning, as it was artfully manufactured, and caused by the substitution of the 2023 Funding Agreement. Thus, because it was equipped with more than enough funding to cover its liabilities even in its second filing, LTL had no need to rehabilitate or reorganize and its petition could not serve the rehabilitative purpose for which Chapter 11 was designed.[23]

Similarly, there is wisdom in waiting to file a bankruptcy petition until flames are present as risks associated with premature filing are great, including a bankruptcy court having to undertake the project of estimating claims on an enormous scale, introducing the possibility of undervaluing future claims as well as underfunding assets to satisfy them.[24] Additionally, premature filing presents the problem of justly compensating vastly different claimants with a broad spectrum of both degrees of exposure and seriousness of injury.[25] Conversely, allowing a longer history of litigation outside of bankruptcy to build can provide a bankruptcy court with more helpful parameters when confronting these issues.[26]

Moreover, it may be true that "from a financial restructuring perspective, a 'wait and see' approach often gives rise to serious risks and increase costs that my threaten the viability of the business"[27] and that "these trials pose enhanced verdict risk – both in terms of an increased risk of verdict for the claimants and an increase risk of larger dollar awards,"[28] but these protests do not overcome the fact that "a debtor who attempts to garner shelter under the Bankruptcy Code . . . must act in conformity with the Code's underlying principles."[29] The

---

[22] Cedar Shore Resort, Inc v. Mueller (In re Cedar Shore Resort, Inc.), 235 F.3d 375, 381 (8th Cir. 2000).

[23] In re Integrated Telecom Express, Inc., 384 F.3d 108, 121 (3d Cir. 2004); see also In re LTL Mgmt., LLC, 64 F.4th at 166.

[24] See Report of the National Bankruptcy Review Commission 343-44 (Oct. 20, 1997).

[25] In re LTL Mgmt., LLC, 64 F.4th 84 (3d Cir. 2023).

[26] Jack B. Weinstein, Individual Justice in Mass Tort Litigation: The Effect of Class Actions, Consolidations and other Multiparty Devices, 280 n. 88, 326 n. 149 (Northwest Press 1995).

[27] In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

[28] Id.

[29] In re SGL Carbon Corp., 200 F.3d 154, 161-162 (3d Cir. 1999).

Bankruptcy Code is not intended to insulate financially secure debtors.[30] Instead, its purpose is to give "the honest but unfortunate debtor a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[31]

Good intentions, such as to protect the J&J brand or comprehensively resolve litigation, do not suffice on their own to merit use of the Bankruptcy Code's safe harbor and disrupt the important pre-bankruptcy rights of claimants.[32]

IMPORTANCE OF THE CIVIL TRIAL BY JURY

Although it ultimately reached the correct result, the court's decision minimizes the importance of claimants' right to prove to a jury of their peers the injuries they allege to be caused by a consumer product. This right was so vital to our Founding Fathers that it was incorporated into the Bill of Rights as the Seventh Amendment to the U.S. Constitution.[33] The importance of the right to a civil trial before the jury of one's peers has roots planted much further back than any corporation's existence, as well as the ability to voluntarily declare bankruptcy.[34] Importantly, the civil jury was designed to defend the individual against "the more powerful and wealthy citizens."[35] English scholars, such as Sir William Blackstone ardently believed that "trial by jury" was the "glory of English law" and "the best preservative of English liberty."[36] America's earliest settlers agreed[37] and, in fact, colonial complaints about deprivation of access to

---

[30] E.g., Barclays-Am./Bus. Credit, Inc. v. Radio WBHP, Inc. (In re Dixie Broad., Inc.), 87 F.2d 1023, 1027-28 (11th Cir. 1989).

[31] Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

[32] See In re Integrated Telecom Express, Inc., 384 F.3d 108, 120 (3d Cir. 2004) (When financially troubled petitioners seek a chance to remain in business the exercise of those powers is justified. Accordingly, we have said the availability of certain debtor-favored Code provisions "assumes the existence of a valid bankruptcy, which in turn, assumes a debtor in financial distress.").

[33] In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

[34] John H. Langbein et al., History of the Common Law: The Development of Anglo-American Legal Institutions 100 (2009) (Elements of the jury system appeared in England in the twelfth century when Henry II introduced the principle that instead of the judicial combat [the tenant] might put himself upon the grand assize, a forerunner of jury trial.).

[35] Blackstone, supra note 6 at *380.

[36] Blackstone, supra note 6, at *379-81.

[37] The right to trial by jury was available for all civil and criminal cases in Virgina by 1624.

the jury even lifted the colonies toward revolution.[38] James Madison once stated "trial by jury . . . is as essential to secure the liberty of the people as any one of the pre-existent rights of nature."[39] Additionally a "Democratic Federalist" was once quoted in the *Federal Farmer* urging his fellow citizens to "never consent to part with the glorious privilege of trial by jury, but with your lives."[40]

As has been recognized for hundreds of years, the jury trial serves a vital function in society because it provides an invaluable forum where all citizens are truly equal before the law. The relative power and influence of both the injured party and injuring party fall away, and decisions are left in the hands of impartial citizens, insulated from interference by the powerful elite since they are not appointed until trial. As Sir William Blackstone so eloquently explains in words that continue to hold true today:

> The most powerful individuals in the state will be cautious of committing any flagrant invasion of another's right, when he knows that the fact of his oppression must be examined and decided by twelve indifferent men, not appointed till the hour of trial; and that, when once that fact is ascertained, the law must of course redress it. This therefore preserves in the hands of the people that share which they ought to have in the administration of public justice and prevents the encroachments of the more powerful and wealthy citizens.[41]

J&J is not an unlucky debtor desperately trying to reorganize in good faith, it is a member of the wealthy elite, attempting to use its power and influence to relocate the dispute over the safety of its talcum powder products out of the hands of jurors and into the more sympathetic bankruptcy forum. Moreover, bankruptcy judges focused on the stability of a business and maximizing return for shareholders are not the proper decisionmakers of these civil disputes, which are meant to be decided by a jury comprised of ordinary citizens who themselves use and trust consumer products.

See Stephen Landsman, The Civil Jury in America: Scenes from an Underappreciated History, 44 Hastings, L. J. 579, 592 (1993).

[38] For example, the Second Continental Congress complained that colonists were deprived "of the accustomed and inestimable privilege of trial by jury, in cases affecting both life and property." Stamp Act, 1765, 5 Geo. 3, c. 12, § 57 (Eng.).

[39] 1 Annals of Cong. 437 (1789) (Joseph Lales ed., 1834) (statement of James Madison).

[40] Letter from A Democratic Federalist (Oct. 17, 1787), as reprinted in The Founders' Constitution at 355.

[41] William Blackstone, Commentaries at 380.

While LTL complained "these trials pose enhanced verdict risk – both in terms of an increased risk of verdict for the claimants and an increased risk of larger dollar awards,"[42] its complaints are in no way relevant to the inquiry at hand. It is civil plaintiffs' hard-fought fundamental right to have these disputes decided by a jury wielding a power belonging to the whole, rather than one controlled by a wealthy few. And there is no reason a corporation with a better credit rating than the U.S. government should be allowed to use legal maneuvering to shirk its obligations to its consumers by seeking refuge in bankruptcy.

Moreover, juries are more than capable of judging the reliability of witnesses brought before them to reach a just decision. Additionally, it should be noted that while a Missouri jury did award $4.69 billion to 22 ovarian cancer patients (later reduced on appeal to $2.24 billion to 20 plaintiffs), since 2018 damages in other monetary awards averaged about $39.7 million per claim, and J&J has often succeeded at trial.[43]

For these reasons, allowing the second bankruptcy to proceed in the continued absence of financial distress would be an assault on the American civil justice system even if "the ends would have justified the means."

EFFECT ON MASS TORTS

As the Third Circuit previously recognized the Bankruptcy Code contemplates "early access to bankruptcy relief to allow a debtor to rehabilitate its business before it is faced with a hopeless situation" but the benefits of an early filing must be balanced against the potential for and risks of premature filing, including the disruption of claimants' pre-bankruptcy remedies.[44]

Additionally, at the time of its second filing LTL had assets valued at $380 million and was entitled to a funding backstop having a value approaching $30 billion, which exceeded the projected talc liability.[45] Here, this funding agreement again provided more than enough financial support to LTL and would allow it to comfortably meet its obligations as they arose. Therefore, LTL was prevented from seeking shelter in the bankruptcy system designed to provide such protection to those without because it was not in financial distress.

---

[42] In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

[43] See In re LTL Mgmt., LLC, 64 F.4th 84 (3d Cir. 2023). These numbers do not take into account the recent single-plaintiff Valadez case, where the jury returned a verdict of $18.8 million in compensatory damages and no punitive damages.

[44] Id.

[45] In re LTL Mgmt., LLC No. 23-12825 (Bankr. D.N.J. July 28, 2023).

Following the opinion, the Talc Claimants Committee rejoiced, declaring the ruling sent a clear message: that multibillion-dollar, wholly solvent companies should not be allowed to use bankruptcy laws to avoid liability and impose cram-down solutions on nonconsenting claimants.[46]

Conversely, in response J&J declared that it commenced its bankruptcy in good faith and announced that it would be appealing the ruling, stating, "We respectfully disagree with the Bankruptcy Court's conclusion that the 'substantial liability' that LTL faces from the massive volume of talc claims asserted against it does not establish 'immediate' financial distress under the standard imposed by the Third Circuit."[47]

Additionally, J&J promised to continue to work with firms allegedly representing 60,000 claimants that voiced their support for the latest Chapter 11 case and the $8.9 billion settlement trust it proposed[48] (a cursory calculation would put this number at less than $150,000 per claimant before attorney's fees and medical liens).

CONCLUSION

Plato believed that a just action could be defined as one which brought about more benefit than harm. If that is the case, then this decision preventing a financially secure corporation from seeking shelter through bankruptcy and disrupting mass tort plaintiffs' pre-bankruptcy remedies is just.

Bankruptcy was intended to be a safe harbor for those in need of its protection, allowing enterprises that wished to continue operating their businesses the ability to pay back creditors through a court-approved reorganization plan fairly reducing their debts, not to give profitable enterprises an opportunity to evade liability. Similarly, jury trials were specifically designed to prevent the encroachments of the more powerful and wealthy citizens.

When imminent financial distress is present, bankruptcy may be an appropriate forum for a debtor to address mass torts liability, but the smoke must be real.

---

[46] See Vince Sullivan, J&J Again Fails to Get Talc Claims Handled in Bankruptcy, Law 360 (July 28, 2023).

[47] Id.

[48] Id.