University of Cincinnati Law Review

Volume 92 | Issue 1 Article 9

October 2023

Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred the Bankruptcy System

Patrick Maney
University of Cincinnati College of Law

Follow this and additional works at: https://scholarship.law.uc.edu/uclr

Part of the Bankruptcy Law Commons, Business Organizations Law Commons, Commercial Law Commons, Consumer Protection Law Commons, Legal Remedies Commons, Litigation Commons, and the Torts Commons

Recommended Citation
Patrick Maney, *Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred the Bankruptcy System*, 92 U. Cin. L. Rev. 269 (2023)
Available at: https://scholarship.law.uc.edu/uclr/vol92/iss1/9

This Student Notes and Comments is brought to you for free and open access by University of Cincinnati College of Law Scholarship and Publications. It has been accepted for inclusion in University of Cincinnati Law Review by an authorized editor of University of Cincinnati College of Law Scholarship and Publications. For more information, please contact ronald.jones@uc.edu.

DIVIDE, "TWO-STEP," AND CONQUER: HOW JOHNSON & JOHNSON SPURRED THE BANKRUPTCY SYSTEM

*Patrick Maney**

I. INTRODUCTION

In late 2018, a jury in Missouri awarded twenty-two plaintiffs $4.69 billion after they allegedly developed ovarian cancer from Johnson's Baby Powder.[1] While the judgment was eventually reduced to $2.24 billion,[2] the result only emboldened more claimants—over 40,000 of whom had sued Johnson & Johnson ("J&J") as of August 2022.[3] To address these claims, J&J executed a divisive merger and filed a Chapter 11 bankruptcy petition.[4] This obscure restructuring maneuver, dubbed a "Texas Two-Step," involves splitting one company into two, allocating assets to a "GoodCo," liabilities to a "BadCo," and then sending the BadCo into bankruptcy.[5] Following J&J's Texas Two-Step, claimants moved to dismiss the bankruptcy, alleging J&J filed the petition in bad faith.[6] The bankruptcy court sided with J&J, but the Third Circuit reversed and remanded the case with instructions to dismiss J&J's petition, and concluded that J&J's BadCo was not in financial distress and thus could not file for Chapter 11 protection.[7] But an hour and thirty-nine minutes after the dismissal, J&J's BadCo subsidiary was back in bankruptcy court, having filed a second petition.[8] While this petition was again dismissed in late July 2023, the bankruptcy court refused to grant the creditors' motion to stop J&J's BadCo from refiling for six months—

---

* Notes & Comments Editor, 2023-2024, Associate Member, 2022-2023, *University of Cincinnati Law Review*. I would like to thank Tanner Dowdy and the rest of the editorial staff for their help with this piece.

1. Lawrence G. Cetrulo et al., *Dust in the Wind: Can Missouri's $4 Billion Talc Verdict Survive Fourteenth Amendment Scrutiny?*, FED. LAW., May/June 2019, at 1, https://www.fedbar.org/wp-content/uploads/2019/05/In-House-Insight-pdf-1.pdf.

2. Lawrence Hurley, *U.S. Supreme Court Rebuffs J&J Appeal over $2 Billion Baby Powder Judgment*, REUTERS (June 1, 2021), https://www.reuters.com/legal/government/us-supreme-court-declines-hear-jj-appeal-over-2-billion-baby-powder-judgment-2021-06-01/.

3. Tiffany Hsu, *Johnson & Johnson Will Discontinue Talc-Based Baby Powder Globally in 2023*, N.Y. TIMES (Aug. 11, 2022), https://www.nytimes.com/2022/08/11/business/johnson-and-johnson-talc-corn-starch.html.

4. *In re* LTL Mgmt., LLC, 637 B.R. 396, 400 (Bankr. D.N.J. 2022).

5. Norman N. Kinel, *The "Texas Two-Step" Firestorm: This Is No Dance!*, THE NAT'L L. REV. (Feb. 22, 2022), https://www.natlawreview.com/article/texas-two-step-firestorm-no-dance.

6. *In re LTL Mgmt., LLC*, 637 B.R. at 400-06.

7. *In re* LTL Mgmt., LLC, 58 F.4th 738, 746 (3d Cir. 2023).

8. Judith Fitzgerald, *LTL, Part Deux (Now with Even More Fraudulent Transfers!)*, JD SUPRA (Apr. 13, 2023), https://www.jdsupra.com/legalnews/ltl-part-deux-now-with-even-more-1483277/.

so the BadCo is expected to file again.[9] As of mid-August 2023, J&J's bankruptcy is in a brief intermission, but with tens of thousands of victims, and tens of billions of dollars on the line, the music is sure to start again and J&J's dance will resume.

Since the advent of the Texas Two-Step, courts and commentators have wrestled with its legality.[10] This Comment seeks to untangle some of these issues. Section II of this Comment provides the history of the J&J talc litigation, as well as how mass torts are handled in both the tort and bankruptcy systems. Section II also explains the divisive merger process and explores several recent cases with an emphasis on J&J's divisive merger and subsequent bankruptcy proceedings.

Section III discusses why the bankruptcy system is the proper venue to resolve this litigation. In addition, Section III argues that the Third Circuit should not have reversed the bankruptcy court's holding. Section III also argues that while J&J's divisive merger was not a fraudulent transfer as it was originally conceived, J&J's post-dismissal maneuver was. Finally, Section III explains that J&J's GoodCo was an alter ego of J&J's BadCo and discusses why the best result would have been for the bankruptcy court to substantively consolidate the GoodCo into the BadCo's bankruptcy case.

II. BACKGROUND

Before exploring J&J's divisive merger, this Section provides context regarding J&J's history and its talcum powder litigation. Additionally, because the J&J talcum powder saga raises complex issues at the interchange of tort, bankruptcy, and corporate law, an overview of these broad areas is necessary. This Section covers each of these topics and proceeds as follows: Part A provides a history of Johnson's Baby Powder and its related litigation. Part B discusses the modern tort system and its deficiencies when handling mass tort litigation. Part C contrasts the tort system with the bankruptcy system, particularly as a forum for resolving mass tort litigation. Part D defines divisive mergers and outlines how J&J executed its Texas Two-Step. Part E then discusses J&J's bankruptcy litigation following its Texas Two-Step. Finally, Part F explores other divisive merger cases.

---

9. Dietrich Knauth, *Judge Rejects 6-Month Bankruptcy Ban for J&J's Talc Subsidiary*, REUTERS (Aug. 11, 2023), https://www.reuters.com/legal/litigation/judge-rejects-6-month-bankruptcy-ban-jjs-talc-subsidiary-2023-08-11/.

10. *See generally* Michael A. Francus, *Texas Two-Stepping out of Bankruptcy*, MICH. L. REV. (June 2022), https://michiganlawreview.org/texas-two-stepping-out-of-bankruptcy/.

A. Johnson's Baby Powder

In 1893, Robert Wood Johnson and his brothers began selling talc-based "Johnson's Baby Powder."[11] The Johnson brothers sought to capitalize on a recent trend in which mothers applied talc to their babies' chafed skin to alleviate diaper rash.[12] The brothers' plan worked: over the next century, their company, J&J, would become one of the largest companies in the world,[13] and Johnson's Baby Powder would eventually dominate the talcum powder industry.[14]

As early as the 1950s, J&J discovered the talc it used in Johnson's Baby Powder contained tremolite, one of the six minerals existing in nature in a fibrous crystal form classified as asbestos.[15] By the 1970s, asbestos was recognized as a primary cause of mesothelioma.[16] Around the same time, the Federal Drug Administration ("FDA") began investigating whether asbestos was present in various talcum powder products.[17] In 1971, J&J provided the FDA with testing from a private lab which found J&J's talc sample contained asbestos in "minor amounts" at a level equal to or less than 1%.[18] In a 1976 letter to the FDA, J&J maintained that asbestos had not been found in any sample of talc produced between December 1972 and October 1973.[19] However, J&J failed to tell the FDA about a 1974 Dartmouth College test which found asbestos in J&J talc, nor did it disclose that asbestos fibers were found in five of seventeen samples

11. Lisa Girion, *Johnson & Johnson Knew for Decades That Asbestos Lurked in Its Baby Powder*, REUTERS (Dec. 14, 2018), https://www.reuters.com/investigates/special-report/johnsonandjohnson-cancer.

12. *Id.*

13. *Market Capitalization of Johnson & Johnson (JNJ)*, COS. MKT. CAP, https://companiesmarketcap.com/johnson-and-johnson/marketcap/ (last visited Nov. 29, 2022) ("As of November 2022 Johnson & Johnson has a market cap of $457.31 Billion. This makes Johnson & Johnson the world's 9th most valuable company by market cap . . . .").

14. *U.S. Population: Which Brands of Body and Baby Powder Do You Use Most Often?*, STATISTA (June 23, 2022), https://www.statista.com/statistics/275421/us-households-brands-of-body-and-baby-powder-used/.

15. Girion, *supra* note 11.

16. *Id.*

17. *Id.*

18. Memorandum of Meeting Between Representatives of Johnson & Johnson Rsch. Div., New Brunswick, N.J. and the Food & Drug Administration on Asbestos Particles in Talc (June 8, 1971) (on file with DocumentCloud) (contributed by Janet Roberts, Thompson Reuters), https://www.documentcloud.org/documents/5012030-1971-J-amp-J-account-of-meeting-with-FDA.html#document/p3/a462061.

19. Letter from George Lee, Dir. of Applied Rsch., Johnson & Johnson, to Dr. Norman F. Estrin, Vice President – Sci., Cosm., Toiletries, & Fragrance Ass'n (Mar. 15, 1976) (on file with DocumentCloud) (contributed by Janet Roberts, Thompson Reuters), https://www.documentcloud.org/documents/5006377-March-15-1976-J-amp-J-Letter-to-FDA.html.

tested by J&J's longtime private lab.[20] To this day, J&J maintains "[it] did not withhold any relevant testing from the FDA" in its 1976 letter.[21]

On December 26, 2006, Deane Berg had both of her ovaries removed after an abnormality was found on an ultrasound.[22] At her follow-up appointment, Ms. Berg was diagnosed with ovarian cancer.[23] While reviewing literature about her diagnosis, she stumbled upon a list of ovarian cancer risk factors, one of which she had encountered daily for the past thirty years—talcum powder.[24] Two years after Ms. Berg's cancer diagnosis, she had her ovarian tissue tested.[25] The test found talc in one ovary.[26] On December 4, 2009, Ms. Berg filed a complaint against J&J alleging that Johnson's Baby Powder caused her ovarian cancer.[27] J&J offered to settle with Ms. Berg for $1.3 million.[28] However, Ms. Berg turned down the settlement because the offer required signing a confidentiality agreement.[29] Her 2013 jury trial (which contained multiple expert witnesses and over twenty studies linking talc and ovarian cancer) found J&J liable for negligence.[30] And yet, the jury did not award Ms. Berg any damages.[31] Though Ms. Berg did not receive any damages, the jury finding against J&J made it easier for future plaintiffs to seek compensation for injuries related to the use of talcum powder.[32]

Five years later, in *Ingham v. Johnson & Johnson*, a jury in Missouri returned a $4.69 billion verdict in favor of twenty-two women over claims that asbestos in J&J talc-based products caused the plaintiffs' ovarian cancer.[33] However, the verdict in *Ingham* was eventually reduced to $2.24 billion in damages.[34] Regardless, the floodgates have opened in response to the recent success of plaintiffs in talc-related cases; as of August, 2022,

20. Girion, *supra* note 11.

21. *Id.*

22. Casey Cep, *Johnson & Johnson and a New War on Consumer Protection*, NEW YORKER (Sept. 19, 2022), https://www.newyorker.com/magazine/2022/09/19/johnson-johnson-and-a-new-war-on-consumer-protection.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. Berg v. Johnson & Johnson Consumer Cos., 983 F. Supp. 2d 1151, 1153-55 (D.S.D. 2013).

28. Jane Ridley, *I Turned Down $1M from Johnson & Johnson, and Blew the Whistle Instead*, N.Y. POST (Mar. 2, 2016), https://nypost.com/2016/03/02/johnson-johnson-hid-the-dangers-of-talc-and-i-helped-blow-the-whistle/.

29. *Id.*

30. *Berg*, 983 F. Supp. 2d at 1161-62.

31. *Id.* at 1154.

32. Cep, *supra* note 22.

33. Cetrulo et al., *supra* note 1, at 12.

34. Hurley, *supra* note 2.

J&J faced more than 40,000 lawsuits from plaintiffs with ovarian cancer and mesothelioma.[35]

B. Mass Tort Litigation and the Tort System

Because mass tort claimants are often numerous and geographically dispersed, courts find it challenging to manage and resolve their claims.[36] This is especially true in asbestos-related claims, which grew from a paltry 950 cases prior to 1980 to approximately 730,000 cases by 2002.[37] The sheer number of asbestos claims makes case-by-case litigation prohibitively expensive, if not impossible.[38] There are also questions as to who really benefits from the litigation: Justice Breyer has observed that for every dollar defendants spend resolving asbestos claims, thirty-nine cents goes to the plaintiffs, and sixty-one cents goes to their lawyers.[39]

While some claimants have turned to class actions to resolve mass tort claims, the Supreme Court has imposed barriers to class certification in the asbestos context.[40] In one asbestos case, *Amchem Prods., Inc. v. Windsor*, the Supreme Court held that the commonality requirement of the Federal Rules of Civil Procedure Rule 23(b)(3) could not be satisfied because the asbestos claimants had different medical histories and were exposed to asbestos in different ways, over different periods of time, which resulted in deadly diseases for some plaintiffs, but no injuries, or injuries that had not yet manifested, for others.[41]

More recently, the widespread use of multi-district litigation ("MDL") has fundamentally changed the tort system.[42] MDLs permit multiple claimants to organize and litigate a case as a singular, efficient group.[43] Indeed, most talc claims J&J faced are organized as large MDLs.[44] However, the MDL system has one major drawback: it is meant only for *pre-trial* coordination of mass tort proceedings.[45] Before the conclusion

35. Hsu, *supra* note 3.

36. Douglas G. Smith, *Resolution of Mass Tort Claims in the Bankruptcy System*, 41 U.C. DAVIS L. REV. 1617, 1616 (2008).

37. *Id.* at 1618.

38. *Id.* at 1627-28.

39. Ortiz v. Fibreboard Corp., 527 U.S. 815, 867 (1999) (Breyer, J., dissenting); *see also* Smith, *supra* note 36, at 1629.

40. *Id.* at 1630.

41. Amchem Prods. v. Windsor, 521 U.S. 591, 624-25 (1997).

42. Jay Tidmarsh, *The Future of Multidistrict Litigation*, 51 CONN. L. REV. 769, 771-72 (2019) ("[as of June 2019] 143,500 cases—or substantially more than one-third of *all* federal civil lawsuits—are pending in an MDL proceeding.") (emphasis added).

43. *Id.* at 773.

44. Cep, *supra* note 22.

45. 28 U.S.C. § 1407(a) ("When civil actions involving one or more common questions of fact are

of pre-trial proceedings, the federal district court administering the MDL must remand each claim to the district from where it was transferred.[46] As such, while MDLs can streamline mass tort litigation, they do not always overcome the inherent challenges posed by large, geographically dispersed lawsuits.

C. Mass Tort Litigation and the Bankruptcy System

In an effort to bypass the tort system, defendant companies have increasingly turned to Chapter 11 of the United States Bankruptcy Code ("the Code") to resolve mass tort claims.[47] Chapter 11 allows a business to restructure its liabilities—including outstanding mass tort claims—so that it may continue operations rather than liquidate entirely.[48] By going through a Chapter 11 restructuring, the business facing a tort judgment (the "debtor") can recognize and preserve value for its creditors and shareholders.[49] The following Parts introduce Chapter 11 and the benefits it offers for entities that face mass tort judgments.

1. The Chapter 11 Process

Bankruptcy courts are courts of equity and are granted broad authority to issue "any order, process, or judgment that is necessary or appropriate" pursuant to § 105(a) of the Code.[50] The underlying principles of the Code seek to prevent a "race to the courthouse" by treating creditors of the same priority equally, creating a plan of reorganization that is fair to different classes of creditors, and preserving value for the business's stakeholders.[51] However, the "absolute priority rule" demands that debt obligations are fully satisfied before shareholders receive any payment.[52] In short, equity holders are not paid unless all classes of creditors are paid first.[53]

After filing, the debtor's property becomes property of the bankruptcy

---

pending in different districts, such actions may be transferred to any district for coordinated or consolidated pretrial proceedings.").

46. *Id.* ("Each action so transferred shall be remanded by the panel at or before the conclusion of such pretrial proceedings to the district from which it was transferred unless it shall have been previously terminated.").

47. Smith, *supra* note 36.

48. 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (16th ed. 2022).

49. *Id.*

50. *In re* Jones, 966 F.2d 169 (5th Cir. 1992); *see also* 11 U.S.C. § 105.

51. 7 COLLIER ON BANKRUPTCY, *supra* note 48, at ¶ 1100.01.

52. 1 COLLIER ON BANKRUPTCY ¶ 1.01 (16th ed. 2022).

53. *Id.*

Maney: Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred th

estate—property held in trust for the benefit of the creditors.[54] However, in Chapter 11 bankruptcy, the Code assumes that the debtor company will manage the estate, and will continue to operate throughout the proceedings and following discharge of bankruptcy.[55] Accordingly, the debtor and its managers generally remain in possession of the estate and business (together the debtor and its managers are referred to as "debtors in possession"). Although the court can, for cause, appoint a trustee to manage the estate and operate the business.[56] Debtors in possession retain substantial control over business operations, and plan negotiations,[57] but have a fiduciary duty to creditors to "preserve and maintain the bankruptcy estate."[58]

Immediately upon filing, the debtor receives the benefit of an "automatic stay" which prevents creditors from collecting prepetition claims against the debtor and the estate.[59] An automatic stay is a nationwide injunction[60] that temporarily prevents creditors from collecting, foreclosing upon, or repossessing estate property.[61] The automatic stay gives debtors time to negotiate and file a plan of reorganization, and also prevents creditors from racing to the courthouse.[62] While an automatic stay generally only halts claims against the debtor's property, courts will occasionally extend the protection of the automatic stay to non-debtor third parties such as guarantors and affiliated entities.[63] The Code protects creditors as well, allowing them to seek relief from the automatic stay,[64] to seek dismissal for bankruptcy petitions filed in bad faith, or to seek dismissal when a reorganization plan is unfeasible, among other remedies.[65] Further, the United States trustee, a nonjudicial, neutral bankruptcy administrator,[66] must appoint a

54. *Chapter 11 – Bankruptcy Basics*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/Chapter-11-bankruptcy-basics.

55. *Id.*

56. *Id.*

57. 7 COLLIER ON BANKRUPTCY, *supra* note 48, at ¶ 1100.01.

58. REGION 18 DIST. OF OREGON CHAPTER 11 GUIDELINES 2 (OFF. OF THE U.S. TR. 2020), https://www.justice.gov/ust-regions-r18/file/ch11_guidelines_eugene.pdf.

59. PRAC. L. BANKR. & RESTRUCTURING & PRAC. L. FIN., AUTOMATIC STAY: OVERVIEW, Westlaw 9-380-7953, https://www.westlaw.com/9-380-7953?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0 (last visited Dec. 1, 2022).

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. 7 COLLIER ON BANKRUPTCY, *supra* note 48, at ¶ 1100.01.

66. 1 COLLIER ON BANKRUPTCY, *supra* note 52, at ¶ 1.01.

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

committee to protect the interests of unsecured creditors,[67] and a representative to protect the rights of future claimants pursuant to § 524(g).[68]

For a company to emerge from bankruptcy, the debtor, its creditors, and stockholders must agree to a plan of reorganization, and it must be implemented.[69] Plans are heavily negotiated, and in addition to containing certain mandatory provisions, commonly address the discharge of existing claims, the terms of any new debt or equity issued, changes in corporate governance, third-party claim releases, and the resolution of pending litigation.[70] Because the Code includes future, unliquidated claims in its definition of a "claim,"[71] the plan must make an allowance to pay future claims with property from the estate.[72] The bankruptcy court will ensure future claims are estimated, and parties can make estimation motions throughout the proceedings.[73] Further, as part of the plan or by motion, the bankruptcy court can craft any number of equitable remedies pursuant to its § 105(a) authority, including consolidating the assets and liabilities of related entities to create a common pool through a process called substantive consolidation.[74] Bankruptcy courts will use substantive consolidation as a remedy when entities are "alter egos" of one another, or when the allocation of assets and liabilities between the entities are arbitrary.[75] In any case, a proposed plan must be approved by shareholders and creditors before it can be confirmed and implemented.[76]

Plan acceptance occurs following an affirmative vote by stockholders and creditors who vote according to the class of their claims.[77] To prevail,

---

67. 7 COLLIER ON BANKRUPTCY, *supra* note 48, at ¶ 1100.01.

68. Mark G. Douglas & Oliver S. Zeltner, *Third Circuit Sets Standards for Appointment of Future Claims Representative in Asbestos Bankruptcy Cases*, JONES DAY (Sept. 2022), https://www.jonesday.com/en/insights/2022/09/third-circuit-sets-standard-for-appointment-of-future-claims-representatives-in-asbestos-bankruptcy-cases.

69. PRAC. L. BANKR. & RESTRUCTURING & PRAC. L. FIN., CHAPTER 11 PLAN PROCESS: OVERVIEW, Westlaw 0-502-7396 [hereinafter CHAPTER 11 PLAN PROCESS], https://www.westlaw.com/0-502-7396?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0 (last visited Dec. 1, 2022).

70. *Id.*

71. 11 U.S.C. § 101(5).

72. *Claim Estimation*, LEXIS (Nov. 28, 2021), https://plus.lexis.com/api/permalink/9ed58e87-0cc9-4e64-b5e7-b76c4cb6f026/?context=1530671 (last visited Dec. 1, 2022); VINCENT J. ROLDAN & PRAC. L. FIN. & PRAC. L. BANKR. & RESTRUCTURING, SUBSTANTIVE CONSOLIDATION IN BANKRUPTCY, Westlaw 7-521-6812 [hereinafter SUBSTANTIVE CONSOLIDATION IN BANKRUPTCY], https://1.next.westlaw.com/7-521-6812?isplcus=true&transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1 (last visited Dec. 1, 2022).

73. *Claim Estimation*, *supra* note 72.

74. SUBSTANTIVE CONSOLIDATION IN BANKRUPTCY, *supra* note 72.

75. *Id.*

76. CHAPTER 11 PLAN PROCESS, *supra* note 69.

77. *Id.*

each class must approve the plan by a two-thirds vote, with votes allocated pro-rata based on the dollar amount of the claim.[78] In an ideal proceeding, the parties will negotiate and approve a plan that stands a realistic chance of success.[79] As such, Chapter 11 proceedings provide an orderly system for the management of creditor liability— be it from banks, bondholders, or mass tort claimants.[80]

2. The Benefits of Chapter 11 for Mass Torts

Chapter 11 proceedings are uniquely adept for resolving mass torts, and provide many advantages over case-by-case litigation, class actions, and MDLs.[81] This is because Chapter 11 provides an efficient forum to achieve a global resolution of claims—both present and future—in a singular proceeding.[82] The first advantage bankruptcy provides is that the automatic stay gives the bankruptcy court time to resolve a large number of competing creditor claims without the possibility of a few creditors levying estate property to the detriment of the many.[83] As such, the automatic stay prevents the "race to the courthouse" present in the tort system.[84] Second, it is common for the bankruptcy court to appoint a representative to ensure rights of future claimants are protected throughout the proceedings.[85] Third, if there are adversary proceedings, Bankruptcy Rule 7042 mandates that Federal Rule of Civil Procedure Rule 42 applies, which permits the court to resolve common issues in one proceeding.[86] Fourth, the estimation process allows the court to estimate the value of contingent claims so that funds can be set aside for future claimants, but ensures the debtor still receives a complete discharge of its liability upon exiting bankruptcy.[87] Fifth, bankruptcy courts are empowered to discharge claims against the debtor, and "channel" future claims to a trust.[88]

Congress has codified "channeling injunctions" for asbestos-related claims in § 524(g) of the Code, and bankruptcy courts can establish post-

78. *Id.*
79. *Id.*
80. *See generally* Smith, *supra* note 36.
81. *Id.* at 1639.
82. *Id.* at 1650.
83. *Id.* at 1639-40.
84. *Id.* at 1640.
85. *Id.*
86. *Id.* at 1646-47. *See also* FED. R. CIV. P. 42.
87. Smith, *supra* note 36, at 1647-48.
88. *Id.*

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

confirmation trusts as part of their broad power to create remedies.[89] The purpose of a § 524(g) trust is to create a pool of assets to pay present and future claimants.[90] Because a portion of the funds will be allocated to pay future, unidentified claimants, a plan of reorganization that creates a § 524(g) trust requires the approval by a supermajority of 75% of the class of asbestos claimants.[91] Once a § 524(g) trust is created, the debtor is relieved from future asbestos liability, while the trust provides creditors with "dedicated sources of recovery."[92]

D. Divisive Mergers and the Texas Two-Step

While the bankruptcy system has long been used to resolve mass tort litigation, corporations have begun using a new tactic derived from an old Texas statute to reorganize their business on the eve of bankruptcy.[93] The divisive merger, known colloquially as a "Texas Two-Step" when used in a bankruptcy context, has garnered significant media and political attention[94]—especially since J&J decided to pursue a divisive merger strategy following the *Ingham* judgment.[95]

Unlike a traditional merger where two or more business entities combine into one, a divisive merger is the opposite; one business entity "merges" into two or more entities.[96] Although technically not considered a transfer or assignment, executing a divisive merger requires the dividing entity to allocate its assets and liabilities among the new entities (or among the new entities and the dividing entity if the dividing entity survives the divisive merger).[97] Divisive mergers provide several advantages over traditional acquisitions and divestitures.[98] Those benefits

---

89. *Id*. at 1648. *See also* 11 U.S.C. § 524(g)(2).

90. Adam Paul et al., *Resolving Mass Tort Liability Through Bankruptcy*, 37TH ANN. SE. BANKR. L. INST. 18 (2011), https://sbli-inc.org/archive/2011/documents/BB_Paul.pdf.

91. *Id.* at 19.

92. JOHN E. HEINTZ ET AL., 3 LAW OF LIABILITY INSURANCE *Mass Tort Bankruptcies* § 27.07, Lexis.

93. *Why the Bankruptcy Maneuver Dubbed the Texas Two-Step Is Controversial*, REUTERS (Aug. 17, 2022), https://www.reuters.com/video/watch/idRCV00BCOA.

94. Kinel, *supra* note 5.

95. *Johnson & Johnson's Billion Dollar Gambit: The Texas Two Step*, SEEKING ALPHA (Oct. 25, 2021) [hereinafter *Billion Dollar Gambit*], https://seekingalpha.com/article/4461714-johnson-and-johnson-stock-asbestos-claims-billion-dollar-gambit-the-texas-two-step.

96. PRAC. L. CORP. & SECS., DIVISIVE MERGERS COMPARISON CHART (DE AND TX), Westlaw W-035-1763 [hereinafter COMPARISON CHART], https://us.practicallaw.thomsonreuters.com/w-035-1763 (last visited Dec. 1, 2022).

97. *Id.*

98. Curtis W. Huff, *The New Texas Business Corporation Act Merger Provisions*, 21 ST. MARY'S L.J. 109, 116 (1989) (explaining that unlike a traditional spin-off, divisive mergers do not require multiple complex closings and conveyances, or shareholder distributions).

include a more streamlined transaction,[99] the ability to avoid transfer restrictions or third-party consents,[100] and greater flexibility in how the transaction is structured.[101]

Currently, the practice is permitted in only a handful of states, and is most commonly associated with Texas, which amended the Texas Business Organizations Code in 1989 to permit divisive mergers.[102] More recently in 2018, Delaware amended the Delaware Limited Liability Company Act to allow divisive mergers for Delaware limited liability companies.[103]

The Texas and Delaware statutes have similar requirements,[104] but this Comment will focus on the Texas statute since J&J executed its divisive merger in Texas.[105] Texas requires the dividing companies to file proper formation documents along with a plan of merger with the Secretary of State.[106] The submitted plan must allocate assets and liabilities among the surviving entities, but any unallocated liabilities or obligations are jointly and severally owned by each new (or surviving) entity.[107] The most distinguishing feature between a Texas divisive merger and a traditional spin-off or divestiture is that the allocation of assets and liabilities are not technically considered transfers or assignments and therefore are not subject to contractual or regulatory restrictions on transfers.[108] However, even if the dividing entity can eschew transfer restrictions, a divisive merger cannot "abridge any right or rights of any creditor under existing law."[109]

While executing a divisive merger in an acquisition or divesture transaction appears benign, companies like J&J that have paired the use of divisive mergers with bankruptcy have spurred controversy.[110] In fact, the House Judiciary Committee recently passed a bill that would prohibit

---

99. *Id.* at 110.

100. COMPARISON CHART, *supra* note 96.

101. *Id.*

102. Huff, *supra* note 98, at 110.

103. *The New Delaware LLC "Divisive Merger" Provision – A Potentially Dangerous Loophole Under Debt Covenants*, KRAMER LEVIN (Aug. 21, 2018), https://www.kramerlevin.com/en/perspectives-search/the-new-delaware-llc-divisive-Merger-provision-a-potentially-dangerous-loophole-under-debt-covenants.html.

104. COMPARISON CHART, *supra* note 96.

105. *Billion Dollar Gambit*, *supra* note 95.

106. *Id.*

107. *Id.*

108. Tex. Bus. Orgs. Code. Ann. § 10.008(a)(2)(C) *See also* Jeffery R. Gleit & Matthew R. Bentley, *The Texas Two-Step: A Problematic Reframing of the Bankruptcy Code Toolkit or an Equitable Solution for Productive Conglomerates and Their Mass Tort Claimants?*, 31 NORTON J. BANKR. L. & PRAC. 148 (2022).

109. TEX. BUS. ORGS. CODE ANN. § 10.901. *See also* Kinel, *supra* note 5.

110. Kinel, *supra* note 5.

companies from filing a bankruptcy petition within ten years of executing a divisive merger.[111]

1. The Mechanics of the Two-Step

The Texas Two-Step works as follows. First, a company with significant tort liability must plan to file for bankruptcy.[112] Prior to filing for bankruptcy, the company converts to a Texas entity, then executes a divisive merger creating two new entities under the Texas Business Organizations Code.[113] In keeping with the requirements of the Code, a plan of merger allocates assets and liabilities among the surviving entities, and the dividing entity is dissolved.[114] The bulk of the assets are allocated to one company (which commentators refer to as the "GoodCo"),[115] while the tort liabilities are allocated to the other (the "BadCo").[116] Step one complete.[117]

Step two: BadCo files a Chapter 11 bankruptcy petition, which renders the liabilities of BadCo immediately subject to the automatic stay.[118] The automatic stay prevents the tort claimants from obtaining property held in the bankruptcy estate while the proceedings are adjudicated.[119] BadCo will then seek an injunction on all lawsuits against non-debtors (such as GoodCo), and use the time bought by the automatic stay to negotiate a plan for resolving the tort claims. [120] Such plans typically include the creation of § 524(g) or § 105(a) trusts.[121]

Recently, commentators have begun to question whether divisive mergers in bankruptcy constitute fraudulent transfers—and whether doing so "abridges any right or rights of any creditor under existing law."[122] While the case law is far from settled, there is good evidence that notwithstanding the legality of the Texas Two-Step, a dividing entity cannot escape liability for a fraudulent transfer even if the division is not

111. Press Release, House Committee on Oversight and Reform, House Judiciary Committee Passes Nondebtor Release Prohibition Act (Nov. 3, 2021), https://oversightdemocrats.house.gov/news/press-releases/house-judiciary-committee-passes-nondebtor-release-prohibition-act.

112. Gleit & Bentley, *supra* note 108, at 151.

113. Kinel, *supra* note 5.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. 11 U.S.C. § 362.

120. 11 U.S.C. § 1121(b).

121. Gleit & Bentley, *supra* note 108, at 152.

122. *Id.* at 154.

considered a "transfer" under Texas law.[123] In short, dividing entities cannot "hinder, delay[,] or defraud claimants by keeping valuable assets out of their hands."[124]

The fear over fraudulent transfers leads to an additional arrangement: GoodCo and BadCo will often enter into a funding agreement requiring GoodCo to fund the liabilities which were allocated to BadCo.[125] Claimants argue such agreements are illusory, because only BadCo can enforce the contract against GoodCo.[126] Further, because the entities are affiliated and will likely have the same managers in charge, BadCo may have little incentive to enforce the agreement against GoodCo.[127]

2. J&J's Texas Two-Step

Since 1979, the year J&J spun off a J&J Baby Products division, multiple subsidiaries have been responsible for selling Johnson's Baby Powder.[128] Following this spin-off, J&J itself has not manufactured or sold Johnson's Baby Powder.[129] On the eve of its Texas Two-Step, Johnson's Baby Powder and the subsequent liability was owned by Johnson & Johnson Consumer, Inc. ("Old JJCI").[130] Old JJCI suffered a significant financial burden as a result of the talcum powder litigation, with cash payments to claimants totaling $3.6 billion in 2020 and 2021.[131] These payments accounted for 51% of Old JJCI's sales, and represented 122% of its pre-tax cashflows.[132] Further, its income before tax declined from a $2.1 billion profit in 2019 to a $1.1 billion loss in 2020, and this loss was directly attributable to the judgment in *Ingham*.[133] Following the Supreme Court's denial of J&J's cert petition in *Ingham*, J&J and its subsidiaries took action to limit its liability by quickly executing a Texas Two-Step.[134]

Through a series of complicated transactions,[135] Old JJCI dismantled itself and split into two new surviving entities.[136] First, Old JJCI's direct

123. *See generally id.* at 154-57.
124. *Id.* at 156.
125. *Id.*at 158-59.
126. *Id.*
127. Francus, *supra* note 10.
128. *Id.*
129. *Id.*
130. *In re* LTL Mgmt., LLC, 637 B.R. 396, 400 (Bankr. D.N.J. 2022).
131. *Id.* at 401.
132. *Id.*
133. *Id.*
134. *Id.* at 400.
135. *See infra* APPENDIX A: DIAGRAM OF J&J'S DIVISIVE MERGER AS OF OCTOBER 2021.
136. *Id.*

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

parent Janssen Pharmaceuticals (a further subsidiary of J&J)[137] created Currahee Holding Company, Inc. ("Currahee") which in turn created Chenango Zero LLC ("Chenango"), a Texas limited liability company, as its wholly owned subsidiary.[138] Following this, Old JJCI merged into Chenango LLC which executed a funding agreement with J&J and Currahee.[139] By executing these transactions, Old JJCI effectively converted itself into a Texas entity.

Next, Chenango, underwent a divisive merger under the Texas Business Organizations Code, creating two new entities, Chenango One LLC, and Chenango Two LLC.[140] Chenango Two LLC merged into Currahee which changed its name to Johnson and Johnson Consumer Inc. ("New JJCI"), while Chenango One LLC changed its name to LTL Management, LLC ("LTL").[141] The bulk of Old JJCI's assets were allocated to New JJCI,[142] while LTL assumed the talc liabilities and acquired Old JJCI's rights under the funding agreement.[143] The October 2021 Amended and Restated Funding Agreement ("Funding Agreement") obligated J&J and New JJCI to fund amounts necessary "(a) to satisfy the [d]ebtor's talc-related liabilities at any time when there is no bankruptcy case and (b) in the event of a [C]hapter 11 filing, to provide funding for a trust."[144] LTL was also allocated $6 million in cash and royalty revenue streams with a fair market value of approximately $367.1 million.[145] Forty-eight hours after completion of the divisive merger, LTL filed a petition for Chapter 11 bankruptcy.[146]

E. In re LTL Mgmt., LLC

Not long after LTL filed its bankruptcy petition, the Official Committee of Talc Claimants ("TCC"), which was appointed by the Bankruptcy Court to represent the interests of the plaintiffs, filed a motion to dismiss LTL's bankruptcy case.[147] The TCC alleged LTL filed its

137. JANSSEN, https://www.janssen.com/ (last visited Nov. 30, 2022).

138. *In re LTL Mgmt., LLC*, 637 B.R. at 401.

139. *Id.*

140. *Id.* at 402.

141. *Id.*

142. Making matters more complicated, in early 2023, New JJCI changed its name to "Johnson & Johnson HoldCo (NA) Inc." and spun off its consumer health assets to its parent "Janssen" which became the direct parent of LTL. *In re* LTL Mgmt., LLC, 652 B.R. 433, 438 (Bankr. D.N.J.). Throughout this piece, when I refer to New JJCI, I refer to the company as it existed in December of 2022.

143. *In re LTL Mgmt., LLC*, 637 B.R. at 401.

144. *Id.*

145. *Id.*

146. Gleit & Bentley, *supra* note 108, at 151.

147. *In re LTL Mgmt., LLC*, 637 B.R. at 403.

Maney: Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred th

petition in bad faith.[148] Specifically, the TCC asserted that LTL's filing was done for the benefit of J&J and New JJCI (among other affiliates) who were extended protections under the automatic stay, even though they did not file for bankruptcy themselves.[149] As explained in Part II.C.1, creditors are prevented from obtaining judgments from entities that are under the protection of the automatic stay. As such, the TCC would be unable to obtain judgments from J&J or New JJCI unless the stay was lifted or LTL's bankruptcy case was dismissed. The TCC further argued that the case should be dismissed because LTL had "no legitimate business purpose," and that J&J's use of the Texas Two-Step was done to force claimants to face a delay and accept discounted settlements.[150]

Whether a bankruptcy petition is filed in good faith is based on "the totality of the facts and circumstances" and is a "fact intensive inquiry."[151] The general analysis must determine "(1) whether the petition serves a valid bankruptcy purpose and (2) whether the petition is filed merely to obtain a tactical litigation advantage."[152] Further, when a company files a bankruptcy petition to address pending litigation, a valid bankruptcy purpose only exists if "the company is experiencing serious financial . . . difficulties . . . ."[153] The bankruptcy court held for LTL, and denied the movants' motion in its entirety.[154] The court found that (1) there was a valid bankruptcy purpose underlying LTL's Chapter 11 filing, (2) LTL was in financial distress, and (3) LTL did not file in order to secure an unfair tactical advantage.[155]

First, the court found that LTL's bankruptcy served "a valid reorganizational purpose."[156] The court notes the standard from *In re Integrated Telecom Express* where the Supreme Court found that the "two main functions of the bankruptcy law" are one, "preserving going concerns" and two, "maximizing property available to satisfy creditors."[157] If either prong is left unsatisfied, then the petition should be dismissed.[158] The court explained that while LTL may not continue as a going concern, a Chapter 11 filing in this case does serve to "maximize property available to satisfy creditors."[159] The court reasoned that "the

148. *Id.* at 406 (citing 15375 Memorial Corp. v. BEPCO, LP., 589 F.3d 605 (3d. Cir. 2009)).
149. *Id.* at 403.
150. *Id.* at 404.
151. *Id.* at 405.
152. *Id.* at 406.
153. *Id.* at 407 (internal quotations omitted).
154. *Id.* at 429.
155. *Id.* at 406-28.
156. *Id.* at 407-08.
157. *Id.* at 407.
158. *Id.*
159. *Id.*

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

filing of a [C]hapter 11 case with the expressed aim of addressing the present and future liabilities associated with the ongoing global personal injury claims is unquestionably a proper purpose under the . . . Code."[160]

The court explained that at the time of the filing, LTL faced nearly 40,000 tort claims, and expected thousands more claims each year for decades.[161] The court reasoned that the Code's allowance for § 524(g) trusts, the opportunity to negotiate a global resolution of the talc liabilities, the process of estimation to set aside funds for future claims, and the breathing room afforded to the debtor under the automatic stay all point to the bankruptcy system as the optimal forum to resolve this litigation.[162] The court also reasoned that the tort system may not be adequate to resolve the litigation, and that future claimants may be "wholly ignored by the current rush to secure judgments against [the] [d]ebtor in the federal and state courts."[163]

Next, the court found that LTL was in financial distress.[164] The court applied the standard from the Third Circuit which is that "some" degree of financial distress is a required precondition to filing a bankruptcy petition, but explained that the Code does not "require any *particular* degree of financial distress."[165] Noting the losses Old JJCI faced in 2020, the court reasoned that LTL faced significant financial distress since LTL became legally responsible for Old JJCI's talc-related liabilities following the divisive merger.[166] The court further explained that if LTL compelled J&J and New JJCI to fund the full $61 billion available under the Funding Agreement, that this expense would "have [had] a horrific impact on these companies, with attendant commercial disruptions and economic harm to thousands of employees, customers, vendors and shareholders . . . ."[167]

Finally, the court found that LTL's petition was not done to "secure an unfair tactical advantage."[168] The court held that Old JJCI's divisive merger was executed properly, in accordance with the Texas Business Organizations Code, and that the interests of present and future litigants had not been impaired.[169] The court further held that the rights of the talc claimants were not materially affected by the divisive merger.[170] The court reasoned that because of the Funding Agreement, LTL had adequate

160. *Id.*
161. *Id.* at 408.
162. *Id.* at 408-09.
163. *Id.* at 414.
164. *Id.*at 417.
165. *Id.* at 420 (emphasis added).
166. *Id.* at 417.
167. *Id.* at 418.
168. *Id.* at 421.
169. *Id.*
170. *Id.* at 427.

funds available to satisfy current and future talc-related claims.[171] The court further reasoned that because LTL submitted itself to the bankruptcy court's jurisdiction, the court could ensure that LTL would compel J&J and New JJCI to fund claims under the Funding Agreement.[172] The bankruptcy court also explained that the divisive merger was proper because bankruptcy filings by J&J or New JJCI themselves would have caused "behemoth bankruptcies" with "extraordinary administrative costs and burdens, significant delays and unmanageable dockets."[173] The bankruptcy court found that there were other valid reasons LTL filed its petition besides to simply gain a litigation advantage; these reasons included LTL seeking the protection of the automatic stay and attempting to resolve liabilities through a § 524(g) trust.[174] Following the court's dismissal, the movants appealed to the Third Circuit, and the Third Circuit reversed.[175]

In contrast, the Third Circuit dismissed LTL's petition, holding that LTL did not file its petition in good faith because LTL was not in financial distress at the time of the filing.[176] The Third Circuit reasoned that LTL was not distressed because it had access to $61 billion pursuant to the Funding Agreement with J&J and New JJCI.[177] However, the Court's holding was narrow, and did not reach the question of whether divisive mergers were permissible when executed on the eve of bankruptcy.[178] The Court's holding also did not preclude LTL from re-filing its petition—in fact, the court reasoned in dicta that if the Funding Agreement were to become insufficient, then perhaps LTL would belong in bankruptcy court.[179] But J&J has good lawyers, so, one hour and thirty-nine minutes after the petition was dismissed, LTL re-filed its petition, and did so after it executed a new funding agreement, this time for only $8.9 billion.[180]

171. *Id.* at 424.

172. *Id.* at 421.

173. *Id.* at 425.

174. *Id.* at 426.

175. *In re* LTL Mgmt., LLC, 58 F.4th 738, 746 (3d Cir. 2023).

176. *Id.* at 762.

177. *Id.* at 759-62 ("We take J&J and LTL at their word and agree. LTL has a funding backstop, not unlike an ATM disguised as a contract, that it can draw on to pay liabilities without any disruption to its business or threat to its financial viability.").

178. *Id.* at 764 ("Some may argue any divisional merger to excise the liability and stigma of a product gone bad contradicts the principles and purposes of the Bankruptcy Code. But even that is a call that awaits another day and another case. For here the debtor was in no financial distress when it sought Chapter 11 protection.").

179. *Id.* at 762 ("What if time shows, with the progression of litigation outside of bankruptcy, that cash available under the Funding Agreement cannot adequately address talc liability? Perhaps at that time LTL could show it belonged in bankruptcy. But it could not do so in October 2021.").

180. *See In re* LTL Mgmt., LLC, 652 B.R. 433, 440-46 (Bankr. D.N.J 2023) (establishing a $8.9 billion trust to pay claimants, and obligating J&J to backstop its subsidiaries' payments under the new funding agreement "solely to fund plan trusts created in connection with this bankruptcy").

But after a series of transactions before this second petition, LTL's direct parent—Johnson & Johnson HoldCo (NA) Inc. ("HoldCo")—also made roughly $22.3 billion available to LTL to pay claimants, bringing the total amount available for LTL to $31.2 billion (the original Funding Agreement provided LTL with $61 billion).[181]

This second petition was dismissed in late July 2023 after the bankruptcy judge explained—with respect to LTL's financial health—"this [c]ourt smells smoke, but does not see fire."[182] However, no settlement is expected unless the bankruptcy court enjoins claimants from filing future lawsuits against J&J and its subsidiaries.[183] Further, the bankruptcy judge refused to prohibit J&J from refiling, so as of August 14, 2023, the door is wide open for J&J to file another petition.[184] J&J needs only to be reasonably sure the judge will "see fire" this time, rather than just "smell smoke."[185]

F. Asbestos and Divisive Merger Precedents

While executing a divisive merger prior to bankruptcy remains a relatively novel restructuring tactic, J&J was not the first to utilize it. The following is a brief overview of two cases that implicated divisive mergers and bankruptcy. Neither were in the Third Circuit.

1. *In re Bestwall LLC*

In *In re Bestwall LLC,* Georgia-Pacific LLC ("Old GP") faced decades of litigation following its acquisition of Bestwall Gypsum Company ("Old Bestwall"), a manufacturer and seller of products that were found to contain asbestos.[186] Due to the magnitude of the litigation, Old GP undertook a Texas Two-Step, and allocated to "New Bestwall" its asbestos liabilities and some assets related to Old Bestwall, while "New GP" received Old GP's assets, and liabilities not related to the asbestos litigation.[187] New Bestwall subsequently filed a Chapter 11 bankruptcy petition.[188] However, New Bestwall and New GP entered into a funding agreement, whereby New GP agreed to fund a § 524(g) asbestos trust with

181. *Id.* at 446.

182. Dietrich Knauth, *J&J Effort to Resolve Talc Lawsuits In Bankruptcy Fails a Second Time*, REUTERS (July 31, 2023), https://www.reuters.com/legal/jj-effort-resolve-talc-lawsuits-bankruptcy-fails-second-time-2023-07-28/.

183. Knauth, *supra* note 9.

184. Knauth, *supra* note 182.

185. Knauth, *supra* note 9.

186. *In re* Bestwall LLC, 605 B.R. 43, 47 (Bankr. W.D.N.C. 2019).

187. *Id.*

188. *Id.*

Maney: Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred th

funds equal to the amount agreed to in New Bestwall's reorganization plan.[189] Following New Bestwall filing its bankruptcy petition, the court-appointed Official Committee of Asbestos Claimants moved to dismiss New Bestwall's bankruptcy case for bad faith.[190] The bankruptcy court denied the Committee's motion.[191]

The court found that the standard to dismiss a Chapter 11 filing for bad faith in the Fourth Circuit is met when, one, "[the reorganization was] objectively futile" and, two, "[the petition was] filed in *subjective* bad faith."[192] The court explained that the Fourth Circuit standard is among the most stringent in the federal courts.[193] The "objectively futile" prong contemplates the debtor's "financial stability," and asks whether there is a going concern to preserve, and whether there is a "realistic hope of rehabilitation."[194] The court held that New Bestwall's filing was not done in bad faith because it was not objectively futile; New Bestwall had assets in excess of $165 million, so New Bestwall was not a "defunct company."[195] The court further explained that resolving an asbestos claim through a § 524(g) trust is a "valid reorganizational purpose," and found that the funding agreement permitted New Bestwall to meet its obligations and "continue as a going concern."[196]

2. *In re DBMP LLC*

In re DBMP LLC concerned another debtor with asbestos liabilities. DBMP's parent company and affiliates went through a complex series of transfers before it executed a divisive merger and funding agreement, and then sent its BadCo ("DBMP") into bankruptcy.[197] Here, although the claimants moved for relief from the automatic stay and not for dismissal for bad faith,[198] the bankruptcy court explained that the result of the requested relief would be much the same since either would end the Chapter 11 case.[199] The court further explained that the Fourth Circuit standard for bad faith dismissal was "exacting" and that it would be

189. *Id.* at 47-48.

190. *Id.* at 46.

191. *Id.* at 54.

192. *Id.* at 48 (citing Carolin Corp. v. Miller, 886 F.2d 693, 700-01 (4th Cir. 1989) (emphasis added).

193. *Id.* (quoting *In re* Dunes Hotel Assocs., 188 B.R. 162, 168 (Bankr. D. S.C. 1995) ("The Carolin court made it clear that the burden of establishing this two-pronged requirement is very high.").

194. *Id.*

195. *Id.* at 49-50.

196. *Id.* at 49.

197. *In re* DBMP LLC, 2021 LEXIS 2194 (Bankr. W.D.N.C. Aug. 10, 2021).

198. *Id.* at *15.

199. *Id.*

Published by University of Cincinnati College of Law Scholarship and Publications, 2023

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

difficult to obtain a dismissal at this early stage in the case.[200] The court held that DBMP should be given the opportunity to negotiate a reorganization plan and pursue a § 524(g) trust without the court prematurely ending the case.[201]

While this court did not grant the claimants' relief sought, the court provided dicta about whether DBMP's divisive merger constituted a fraudulent transfer.[202] The court explained that the Texas divisive merger statute was not intended to "have any material effect on the existing rights of creditors" and that "if in a merger with multiple survivors, the parties allocate a creditor's claim to an inadequately capitalized or insolvent corporation, that creditor will have the right to challenge the merger as a fraudulent transfer."[203]

DMBP insisted it was adequately capitalized because of the funding agreement its parent executed to pay claimants, and thus, there was no fraudulent transfer.[204] The court read the plain meaning of the Texas Business Organizations Code and asked "were the rights of creditors, here asbestos claimants, and future demands, *materially* affected by the Merger and its asset and liability allocation?"[205] The court answered "yes," and reasoned that before the divisive merger, asbestos claimants had the same rights to "access" the old entity's assets as any other unsecured creditor; however, following the divisive merger, asbestos claimants were "placed one step beyond [these] assets."[206] The court reasoned that because the funding agreement was conditional, and could only be enforced by DBMP asserting its rights against the other parties to the agreement, the divisive merger "had a material, negative effect on the asbestos creditors' ability to recover on their claim . . . ."[207]

III. DISCUSSION

While the Third Circuit's decision provided a temporary victory for claimants, its impact was underwhelming. The decision did not have ramifications beyond LTL and its creditors, and questions about the legality of the Texas Two-Step remain unanswered.[208] The appellants had argued LTL's Texas Two-Step threatened the public interest and provided

200. *Id.*
201. *Id.*
202. *Id.* at *61-67.
203. *Id.* at *64.
204. *Id.* at *66.
205. *Id.* (emphasis added).
206. *Id.* at *66-67.
207. *Id.*
208. *See generally In re* LTL Mgmt., LLC, 58 F.4th 738 (3d Cir. 2023).

Maney: Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred th

a "blueprint [where] any company could shed tort or other liability."[209] Indeed, some commentators have gone so far as to attack the entire bankruptcy system's handling of tort claims, and have loudly declared that LTL's and other tort-liability bankruptcies are "fake" and "fraudulent as hell."[210]

This Section confronts these contentions. Part A argues why the bankruptcy system remains the most appropriate forum to resolve this litigation. Part B concludes that the Third Circuit should not have dismissed LTL's petition for bad faith. Part C argues J&J's divisive merger as it was originally conceived was not a fraudulent transfer, although its post-divisive merger maneuvers likely were. Finally, Part D argues New JJCI—as it existed in December of 2022—was an alter ego of LTL and should have been consolidated into LTL's bankruptcy.

A. The Bankruptcy System, Not the Tort System, is the Appropriate Forum to Resolve J&J's Talc Litigation

The challenges of large-scale case-by-case litigation, the difficulties of certifying asbestos class actions, and the procedural shortcomings of MDLs lead to an unfortunate irony: the tort system often offers inadequate remedies for asbestos tort claimants. The facts leading up to LTL's bankruptcy highlight this reality. While J&J faced 40,000 pending asbestos-related claims, since 2014, only forty-nine trials have produced a verdict, and over 1,500 cases have been dismissed.[211] Further, the results in these cases have been dramatically inconsistent; the plaintiffs have only won around 50% of the time.[212] Those who did win—like the *Ingham* plaintiffs—won big.[213]

But these drawbacks are not present in a bankruptcy forum. Instead of playing claimant "whack-a-mole," bankruptcy's automatic stay can provide J&J with time to put together a plan of reorganization that properly estimates and accounts for future, unliquidated claims, without having to worry about depletion of the estate by creditors who "win" the

209. Brief for Appellant Off. Comm. of Talc Claimants & Joint Appendix Volume 1 of 20 (Pages A1 to A272) at 38, *In re* LTL Mgmt., LLC, 637 B.R. 396 (Bankr. D.N.J. 2022) (No. 22-2009) [hereinafter Brief for Appellant].

210. Max Kennerly, *How Giant Corporations Are Using Fake Bankruptcies to Hang Consumers Out to Dry*, BALLS & STRIKES (Sept. 7, 2022), https://ballsandstrikes.org/legal-culture/texas-two-step-bankruptcy/.

211. *In re LTL Mgmt., LLC*, 637 B.R. at 412.

212. Donald L. Swanson, *Bankruptcy: The BEST Way to Address Mass-Tort Claims Against Johnson & Johnson (In re LTL)*, AM. BANKR. INST., https://www.abi.org/feed-item/bankruptcy-the-best-way-to-address-mass-tort-claims-against-johnson-johnson-in-re-ltl.

213. *Id.*

Published by University of Cincinnati College of Law Scholarship and Publications, 2023

race to the courthouse.[214] The reorganization plan would also benefit creditors, particularly asbestos victims, that face a long latency period for bringing a claim. Said another way, by the time some asbestos victims come forward, the debtor's assets might be completely depleted by juries willing to award multi-billion-dollar judgments.[215] The bankruptcy system would avoid this problem by ensuring future claimants get *something*. Here, if a plan is confirmed by 75% of the class of asbestos claimants, the § 524(g) trust would provide an evergreen source of funds[216] to solve this latency problem and pay claimants for decades.[217] The fact that asbestos trusts have been codified[218] suggests that Congress understood the value in utilizing the bankruptcy system to resolve mass tort claims.[219] Courts should defer to the wisdom of our democratic process and permit debtor companies to use the bankruptcy system for its intended purpose.

Bankruptcy also provides J&J and its affiliates with an efficient forum to resolve the talc litigation in one proceeding and precludes vexatious litigation and collateral attacks. The Washington Legal Foundation argued in its amicus brief that this "centralization" of claims preserves the value of the estate because, rather than J&J having to defend and provide discovery in countless jurisdictions in both state and federal court, J&J can instead litigate the proceedings in one venue—the bankruptcy court.[220]

Indeed, the defense costs that Old JJCI faced prior to the divisive merger and bankruptcy were $10-20 million per month.[221] The appellees argued these costs would have grown astronomically once the 35,000 cases consolidated in the New Jersey MDL were remanded back to their

214. 7 COLLIER ON BANKRUPTCY, *supra* note 48, at ¶ 1100.01.

215. Swanson, *supra* note 212.

216. Sander L. Esserman & David J. Parsons, *The Case for Broad Access to 11 U.S.C. § 534(g) in Light of the Third Circuit's Ongoing Business Requirement Dicta in* Combustion Engineering, N.Y.U. ANN. SURV. AM. L. 62, 188-90 (2006).

217. *See generally id.* at 190-93.

218. 11 U.S.C. § 524(g).

219. Mark D. Plevin & Tacie H. Yoon, *A Look Back at Mass Tort Bankruptcy Cases in 2019 – Asbestos and Beyond*, CROWELL (Jan. 22, 2020), https://www.crowell.com/NewsEvents/AlertsNewsletters/all/A-Look-Back-at-Mass-Tort-Bankruptcy-Cases-in-2019-Asbestos-and-Beyond#:~:text=Fla.,-12%2F12%2F2019&text=Section%20524(g)%20was%20added,Johns%2DManville%20asbestos%20bankruptcy%20case. ("Section 524(g), which Congress explicitly modeled on the Manville channeling injunction, expressly permits future asbestos claims to be enjoined and channeled to a trust if the statute's many requirements are met.").

220. Brief of Wash. Legal Found. as Amicus Curiae in Support of Debtor-Appellee & Affirmance at 5, *In re* LTL Mgmt., LLC, 637 B.R. 396 (Bankr. D.N.J. 2022) (No. 22-2009).

221. Brief for Debtor-Appellee at 16, *In re* LTL Mgmt., LLC, 637 B.R. 396 (Bankr. D.N.J. 2022) (No. 22-2009).

proper jurisdictions following the completion of pre-trial litigation.[222] Further, J&J estimated that each ovarian cancer case costs between $2-5 million to try.[223] But one of the principle aims of bankruptcy is to preserve the value of a business so that all creditors can be fairly compensated.[224] When considering this, it becomes clear that the bankruptcy system is preferable to resolve these claims since relying on the tort system would result in significantly fewer assets not only for the debtor, but also for the claimants.

B. The Third Circuit Should Not Have Held That the Bankruptcy Court Abused its Discretion by Refusing to Dismiss LTL's Petition for Bad Faith

When a bankruptcy court refuses to dismiss a Chapter 11 case for bad faith, the Third Circuit employs an "abuse of discretion" standard of review.[225] In the Third Circuit, an abuse of discretion occurs when the bankruptcy court's decision "rests upon a clearly erroneous finding of fact, an errant conclusion of law, or an improper application."[226] Applying this standard, the Third Circuit should not have found the bankruptcy court abused its discretion for failing to dismiss LTL's petition for the following reasons.

The appellants made two primary arguments in support of their appeal: one, that the automatic stay should be lifted against the non-debtor affiliates, and two, that the case should be dismissed for lack of good faith.[227] As the appellees convincingly argued in their brief, it is well established that the bankruptcy court may extend the automatic stay to non-debtors pursuant to their authority in § 105(a).[228] Further, § 362(a) permits a bankruptcy court to extend the automatic stay to third-parties, when non-debtors and the debtor "enjoy such an identity of interests that a lawsuit asserting talc-related claims against the [non-debtors] is essentially a suit against [the debtor]".[229] Given the Funding Agreement, and the fact that LTL is a fellow subsidiary of J&J, there was *clearly* an "identity of interests" between LTL, New JJCI and J&J; therefore, the

222. *Id.*

223. *Id.*

224. 7 COLLIER ON BANKRUPTCY, *supra* note 48, at ¶ 1100.01.

225. *In re* Integrated Telecom Express, Inc., 384 F.3d 108, 118 (3d Cir. 2004) (citing *In re* PPI Enters. (U.S.), Inc., 324 F.3d 197, 211 (3d Cir. 2003)).

226. *Id. See also* Rode v. Dellarciprete, 892 F.2d 1177, 1182 (3d Cir. 1990) (stating that an abuse of discretion occurs when "no reasonable person" would adopt the court's view).

227. *See generally* Brief for Appellant, *supra* note 209.

228. Brief for Debtor-Appellee, *supra* note 221, at 76.

229. *Id.* at 78.

bankruptcy court almost certainly did not abuse its discretion when it extended the automatic stay to related non-debtors. As such, this Comment only considers the appellants' second argument in more depth.

As the court explained in *In re LTL Mgmt., LLC*, determining what amounts to good faith is a fact-based inquiry based on the totality of the circumstances.[230] However, Third Circuit precedent established a two-prong test that finds a bad faith filing when one, there was no "valid bankruptcy purpose" and two, the petition was filed "merely to obtain a tactical litigation advantage."[231] There is a further condition that a "valid bankruptcy purpose" only exists if the debtor is facing "serious financial difficulties."[232] Lastly, to demonstrate good faith, there is an overarching common law requirement that the debtor must conform "with the Code's underlying principles."[233]

The appellants' brief devoted several pages to the argument that LTL was not in serious financial distress because the October 2021 Funding Agreement obligated New JJCI and J&J to satisfy LTL's talc liabilities up to approximately $61 billion.[234] This argument appears convincing at first glance, but recall the size of the *Ingham* judgment: twenty-two asbestos plaintiffs were awarded $2.2 billion.[235] Following J&J's Texas Two-Step, LTL owned the liabilities for 40,000 such claims, and all unliquidated claims "for decades to come."[236] The debtor introduced evidence that, had LTL not filed a Chapter 11 petition, the cost of *trying* all pending claims would have been $190 billion,[237] and resolving all claims could have cost hundreds of billions of dollars.[238] Certainly, this is evidence that LTL believed in good faith that it was in serious financial distress.

But the Third Circuit rejected this argument, and held that the existence of the Funding Agreement meant that LTL was not in financial distress.[239] Ironically, the appellants themselves argued that this "Two-Step plus funding agreement" arrangement violated the absolute priority rule because J&J and New JJCI could pay other creditors and shareholders

230. *In re LTL Mgmt., LLC*, 637 B.R. at 405 (citing *In re* Integrated Telecom, 384 F.3d 108, 118 (3d Cir. 2004)).

231. *Id.* at 406 (quoting *In re* 15375 Mem'l Corp., 589 F.3d 605, 618 (3d Cir. 2009).

232. *Id.*

233. Brief for Appellant, *supra* note 209, at 19 (citing *In re* SGL Carbon Corp., 200 F.3d 154, 161 (3d Cir. 1999)).

234. *Id.* at 39-43.

235. Hurley, *supra* note 2.

236. *In re LTL Mgmt., LLC*, 637 B.R. at 408.

237. *Id.* at 419.

238. Brief for Debtor-Appellee, *supra* note 221, at 35.

239. *In re* LTL Mgmt., LLC, 64 F.4th 84, 107 (3d Cir. 2023).

before the asbestos claimants.[240] But if that is true, then the October 2021 Funding Agreement clearly was not an adequate mechanism to ensure LTL's financial efficacy. Further, J&J's subsequent shrinking of the Funding Agreement and LTL's ability to refile its petition demonstrated how fruitless the Third Circuit's holding was. If J&J can disavow the October 2021 Funding Agreement, this mechanism cannot possibly be the basis for LTL's purported financial health. More on this in Part C.

A debtor seeking resolution through a § 542(g) trust should in and of itself be a "valid reorganizational purpose."[241] The facts in this case are analogous to Bestwall, where the bankruptcy court refused to dismiss a debtor's petition for bad faith even under the more stringent Fourth Circuit standard.[242] In this case, the October 2021 Funding Agreement specifically contemplated resolving the case through a § 524(g) trust.[243] The appellees' brief explicitly stated that pursuing a § 524(g) trust was the purpose of the bankruptcy.[244] The bankruptcy court concluded just that.[245] So, the standard for good faith from Bestwall is satisfied, because LTL's goal of resolving the litigation with a § 524(g) trust is a "valid bankruptcy purpose." With an eye toward the benefits of resolving this case in the bankruptcy system, the Third Circuit should have permitted the parties to negotiate a plan, as the courts did in both Bestwall and DBMP, and not dismissed the petition so early in the case.

C. J&J's Texas Two-Step Was Not Itself a Fraudulent Transfer, But its Post-Dismissal Maneuver Almost Certainly Was

Commentators and scholars following this case have concluded that J&J's divisive merger was an obvious fraudulent transfer.[246] But is that correct? Under the Code, fraudulent transfers are impermissible, and can be "avoided" if the transferor—with actual intent—"hinder[ed], delay[ed], or defraud[ed] any entity to which the debtor was indebted, or if the debtor received less than a reasonably equivalent value in [the]

240. Brief for Appellant, *supra* note 209, at 33.

241. *In re* Bestwall LLC, 605 B.R. 43, 49 (Bankr. W.D.N.C. 2019).

242. *Id.*

243. Declaration of John K. Kim in Support of First Day Pleadings, Annex 2: Amended & Restated Funding Agreement at 6, No. 21-30589-MBK (Bankr. D.N.J. Oct 14, 2021) [hereinafter Amended and Restated Funding Agreement].

244. Brief for Debtor-Appellee, *supra* note 221, at 63.

245. *In re* LTL Mgmt., LLC, 637 B.R. 396, 409 (Bankr. D.N.J. 2022).

246. Francus, *supra* note 10.

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

exchange."[247] This power allows transfers to be "set aside" if they "unfairly or improperly deplete assets of the estate to the detriment of creditors."[248] If a transfer is deemed fraudulent, the assets are clawed back and then made available to creditors.[249]

Whether J&J's divisive merger constituted a fraudulent transfer is specifically contemplated in the U.S. trustee's brief in support of the Appellants in *In re LTL Mgmt., LLC*.[250] The U.S. trustee argued that it would almost certainly be a fraudulent transfer if, instead of executing a divisive merger, Old JJCI had simply transferred its assets to another J&J affiliate prior to filing a bankruptcy petition.[251] Indeed, in *In re Tronox*, a corporation executed a spin-off and allocated $40 million of assets to a new entity along with "billions" in environmental liabilities before sending the new entity into bankruptcy.[252] The bankruptcy court found the allocation to the spin-off to be a fraudulent transfer because the new entity was not granted "reasonably equivalent value," and the court reasoned this maneuver hindered creditors.[253] While J&J's divisive merger was not literally a "spin-off" in form, one could argue it produced the same result in function, except there was one key difference: that pesky Funding Agreement.

In J&J's case, LTL originally received approximately $373.1 million worth of assets,[254] while taking on liabilities worth "hundreds of billions of dollars," in J&J's own estimation.[255] By contrast, New JJCI received substantial assets and had a market value of $61 billion following the divisive merger.[256] At first glance this exchange seems remarkably inequitable; however, the Funding Agreement obligated both New JJCI and J&J to fund LTL's obligations up to the market value of Old JJCI,[257] calculated immediately prior to its divisive merger.[258] If we accept the October 2021 Funding Agreement at face value, then it is reasonable to

---

247. Brief for Andrew R. Vara, U.S. Tr., as Amicus Curiae in Support of Appellants & Supporting Reversal at 21, *In re* LTL Mgmt., LLC, 637 B.R. 396 (Bankr. D.N.J. 2022) (No. 22-2003) (internal quotations omitted); *see also* 11 U.S.C. § 548.

248. Brief For Andrew Vara, *supra* note 247, at 21 (citing Merit Mgmt. Grp. v. FTI Consulting Inc., 138 S. Ct. 883, 888 (2018)).

249. *Id.*

250. *Id.*

251. *Id.*

252. *In re* Tronox Inc., 503 B.R. 239, 251 (Bankr. S.D.N.Y. 2013).

253. *Id.* at 283.

254. *In re* LTL Mgmt., LLC, 637 B.R. 396, 402 (Bankr. D.N.J. 2022).

255. Brief for Debtor-Appellee, *supra* note 221, at 35.

256. *Id.* at 21.

257. *See* Amended and Restated Funding Agreement, *supra* note 257, at 4 (the Funding Agreement references "Chenango" instead of Old JJCI, but this is because Old JJCI merged into Chenango Zero, LLC prior to the divisive merger).

258. *Id.*

conclude creditors would be no worse off under this arrangement. This is because whether or not the Texas Two-Step occurred, $61 billion would have been available to creditors. Either creditors could have been paid $61 billion from Old JJCI's market value, or creditors could have been paid from $61 billion of New JJCI and J&J's funds. But the arrangement under the October 2021 Funding Agreement may have actually been better for creditors since J&J was *also* on the hook for the full amount, not just Old or New JJCI. And this was the key fact the Third Circuit relied on in its holding—that because big, powerful J&J guaranteed these payments, *LTL* was solvent, or at least, not financially distressed.[259]

The bankruptcy court in *In re DBMP* was skeptical of this Two-Step plus funding agreement arrangement, but the circumstances in that case were different.[260] For example, DBMP's parent corporation was only obligated under the Funding Agreement once DBMP exhausted all reserves and any cash distributions from another of the parent's subsidiaries.[261] Further, DBMP's funding agreement could only be used to pay asbestos-related liabilities for the purpose of funding a § 524(g) trust.[262] But LTL's October 2021 Funding Agreement was far less conditional.[263] For example, LTL would not have had to liquidate before it could request funds, and it could do so directly from J&J, and not first from a subsidiary.[264] Also, the funds could be used to pay claims in and out of bankruptcy—including to establish § 105 or § 524(g) trusts—and could be used for any costs LTL incurred in the normal course of its business.[265]

It is true that the title to valuable assets remained with New JJCI and J&J, rather than within LTL's bankruptcy estate, but this does not in and of itself cause a detriment to creditors. This is because the rights that LTL had under the October 2021 Funding Agreement are *themselves* estate property.[266] Yes, had Old JJCI filed a Chapter 11 petition, all $61 billion of its market value would have been included in the estate. But market value is not a pile of cash that can be freely spent, rather, market value is an estimate of the present value of all future earnings adjusted for the time

259. *In re* LTL Mgmt., LLC, 64 F.4th 84, 107 (3d Cir. 2023).

260. *See generally In re* DBMP LLC, 2021 Bankr. LEXIS 2194, at *107 (Bankr. W.D.N.C. Aug. 10, 2021).

261. *Id.* at *32.

262. *Id.* at *81.

263. *See generally* Amended and Restated Funding Agreement, *supra* note 257.

264. *Id.* at 6.

265. *Id.*

266. 11 U.S.C. § 541(a)(1) ("The commencement of a [bankruptcy case] creates an estate. Such estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case.").

value of money.[267] Consider that Old JJCI's future earnings would likely have been completely dependent on enforcing third parties contracts as well—namely, sales contracts with retail stores that sold Old JJCI's consumer products. These are no more illusory, and no more difficult for the bankruptcy court to enforce than the Funding Agreement.

Granted, this arrangement has the *potential* for abuse. For example, it would have been a fraudulent transfer if New JJCI and J&J had refused to pay LTL, or transferred funds to other stakeholders, such that there would be insufficient funds to pay talc claimants or fund the trust. In these circumstances, the transactions could have been set aside as fraudulent transfers since they would have resulted in LTL having not received reasonably equivalent value in the exchange. But there can be no fraudulent transfer until an abuse occurs.

But two years after LTL's divisive merger, in August 2023, such an abuse probably did occur. In response to the Third Circuit's holding that LTL was not in financial distress, J&J amended the Funding Agreement such that LTL now only had access to $31.2 billion instead of the full $61 billion.[268] Reducing the funds available to pay creditors by roughly $30 billion certainly "hindered" creditors. Further, this reduction by $30 billion likely meant that LTL no longer had received reasonably equivalent value in the transaction. All parties had agreed—for nearly two years—that $61 billion was appropriate consideration for the divisive merger. Now, $31.2 billion is the correct amount. But why? Why is the equivalent value $30 billion less now than it was then? To be clear, the divisive merger as it was originally conceived was not a fraudulent transfer. But this latest maneuver smacks of fraud.

Of course, had the Third Circuit not dismissed LTL's bankruptcy, then there would have been no need for J&J to try to shrink the Funding Agreement. The case would currently be in the proper forum—the bankruptcy system—and all parties would be able to negotiate an equitable solution to the problem. But as of August 2023, J&J is between a rock and a hard place. On one hand, it cannot get back into bankruptcy court unless LTL is in financial distress, but it also cannot show that LTL is in financial distress without shrinking the Funding Agreement which is likely a fraudulent transfer.

267. *Free Cash Flow Valuation*, CFA INST. (Aug. 28, 2023), https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/free-cash-flow-valuation.

268. *See supra* Part II.E.

D. Instead, New JJCI should Have Been Consolidated into LTL's Bankruptcy Because New JJCI Was an Alter Ego of LTL

As discussed in Part III.A, kicking this case back to the tort system is worse for all parties—except for a lucky few plaintiffs' lawyers. Here is what should have happened. The Third Circuit should have allowed LTL's bankruptcy case to continue with the October 2021 Funding Agreement in force, but, New JJCI should have been substantively consolidated into LTL's bankruptcy since New JJCI is an alter ego of LTL.[269] This result would have been a compromise that (1) kept the case in the bankruptcy system, but (2) produced the same result as having Old JJCI declare bankruptcy itself, and (3) given an added benefit to creditors, granting them access to J&J's funds as a backstop.

Entities are said to be alter egos when they have "excessive unity" or when assets and liabilities are allocated arbitrarily between the entities.[270] The Supreme Court explained in *Wellness Int'l Network, Ltd. v. Sharif* that "[a] fraudulent conveyance claim seeks assets in the hands of a third party, while an alter ego claim targets only the debtor's second self."[271] When entities are found to be alter egos, bankruptcy courts can substantively consolidate them pursuant to the court's § 105(a) power.[272] The effect of substantive consolidation is that the assets of the alter ego entity are included in the debtor's bankruptcy estate and subsequent proceedings.[273]

Courts consider multiple factors to determine if substantive consolidation is appropriate, including: (1) the sharing of management, (2) the parent paying salaries of subsidiary employees, (3) the existence of intercompany guarantees on loans, (4) a subsidiary having grossly inadequate capital, (5) a subsidiary having no assets except those conveyed to it by a parent, (6) the directors taking direction from the parent and not acting in the interest of the subsidiary, and (7) affiliates acting from the same business location.[274] In LTL's case, except for perhaps in prong (4), all preceding factors are satisfied: (1) and (2); LTL's managers are paid by and work for J&J;[275] (3): the original Funding

---

269. Hon. Judith K. Fitzgerald et al., *The Texas Two-Step: A Different Look at Bankruptcy Code Section 548 and Concluding Thoughts*, HARV. L. SCH. (Nov. 1, 2022), https://bankruptcyroundtable.law.harvard.edu/2022/11/01/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-a-different-look-at-sec-548-and-concluding-thoughts/.

270. *Id.*

271. Wellness Int'l Network, Ltd. v. Sharif, 575 U.S. 665, 694 (2015).

272. SUBSTANTIVE CONSOLIDATION IN BANKRUPTCY, *supra* note 72.

273. *Id.*

274. *Id.*

275. Brief for Appellant, *supra* note 209, at 10.

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

Agreement obligated J&J and New JJCI to pay LTL's asbestos judgment creditors;[276] (4): the divisive merger allocated $373.1 *million* of assets to LTL,[277] but "hundreds of *billions* of dollars" of liabilities;[278] (5): all of LTL's assets were allocated from Old JJCI;[279] (6): LTL's directors forced it into bankruptcy so that Old JJCI/New JJCI would not have to bear that burden themselves;[280] and finally, (7): LTL's office is in a J&J building.[281] Also, it is on record that LTL's bank account was not even in its own name as of the date of its first bankruptcy petition.[282]

However, in 2005, the Third Circuit narrowed its alter ego analysis in *In re Owens Corning* and now considers a two-prong test: one, "pre[-]petition [the entities] disregarded separateness so significantly their creditors rel[y] on the breakdown of entity borders and [treat] them as one legal entity" or two, "post[-]petition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors."[283] Because the facts in *In re Owens Corning* dealt with a debtor's liability for a bank loan, the two-prong analysis does not fit perfectly for tort claims.[284] But, in J&J's case, the divisive merger that created LTL and New JJCI was executed forty-eight hours prior to the original bankruptcy;[285] so, pre-petition, these entities certainly "disregarded separateness" and were "treated as one legal entity" because they were literally the same entity when the creditors' claims arose. Therefore, the test from *In re Owens Corning* is satisfied.

Finally, appellees invited an alter ego claim in their brief. Appellees argued the automatic stay should have been extended to New JJCI because this was an "unusual circumstance" where "there [was] such identity between the debtor and the third-party defendant . . . that a judgment against the third-party defendant [would] in effect be a judgment or finding against the debtor."[286] This characterization seems to fit the "excessive unity" definition of alter ego. With this in mind, and given that LTL and New JJCI satisfy both traditional alter ego factors and the analysis from *In re Owens Corning*, New JJCI should have been

276. *In re* LTL Mgmt., LLC*,* 637 B.R. 396, 402 (Bankr. D.N.J. 2022).

277. *Id.*

278. Brief for Debtor-Appellee, *supra* note 221, at 35. This point is debatable since the funding agreement arguably makes LTL whole, but the defendant-appellees clearly disagree since the crux of their argument was that LTL was in financial distress.

279. *In re* LTL Mgmt., LLC, 637 B.R. at 402.

280. *Id.* at 425.

281. Brief for Appellant, *supra* note 209, at 10.

282. *Id.*

283. SUBSTANTIVE CONSOLIDATION IN BANKRUPTCY, *supra* note 72.

284. *See generally In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005).

285. Gleit & Bentley, *supra* note 108, at 151.

286. Brief for Appellant, *supra* note 209, at 80.

Maney: Divide, "Two-Step," and Conquer: How Johnson & Johnson Spurred th

substantively consolidated into LTL's bankruptcy, and all its assets—as it existed in December of 2022— should have been included in LTL's estate.

IV. CONCLUSION

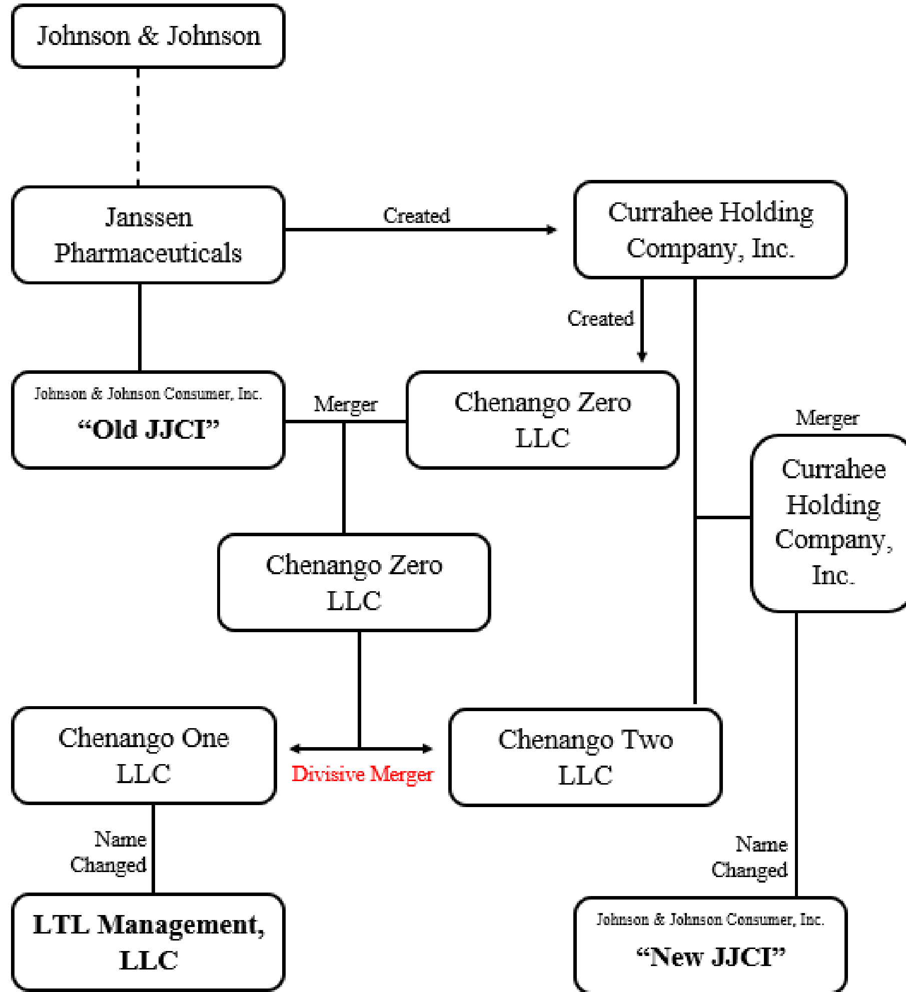
While the Texas Two-Step remains a highly controversial maneuver in the context of mass torts, the Third Circuit should not have found that the bankruptcy court abused its discretion when it refused to dismiss LTL's bankruptcy petition for bad faith. This is because J&J and LTL's goal of resolving the litigation through a § 524(g) trust should be a "valid bankruptcy purpose" as other courts have held. Further, J&J's Texas Two-Step was not a fraudulent transfer because the Funding Agreement provided reasonably equivalent value for LTL. However, J&J's shrinking of the Funding Agreement following the first Chapter 11 dismissal *was* likely a fraudulent transfer. Regardless, New JJCI—as it existed in December 2022—and LTL were likely alter egos of each other, so the court should have used the equitable remedy of substantive consolidation to include New JJCI's assets in LTL's bankruptcy estate.

Ultimately, the bankruptcy system is the appropriate forum to resolve these asbestos claims because bankruptcy permits the parties to resolve the litigation in one proceeding, because the bankruptcy system fairly accounts for future claims, and because the bankruptcy system better preserves value for creditors. However, if J&J is permitted to use the bankruptcy system to resolve these claims, then all remedies and rights should be rigorously enforced. Accordingly, in adjudicating Texas Two-Step bankruptcies, fraudulent transfers and the doctrine of alter ego should be routinely considered.

Published by University of Cincinnati College of Law Scholarship and Publications, 2023

University of Cincinnati Law Review, Vol. 92, Iss. 1 [2023], Art. 9

APPENDIX A
DIAGRAM OF J&J'S DIVISIVE MERGER AS OF OCTOBER 2021[287]



287. *See In re* LTL Mgmt., LLC, 637 B.R. 396, 401-02 (Bankr. D.N.J. 2022).

https://scholarship.law.uc.edu/uclr/vol92/iss1/9