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Aggregation and Abuse: Mass Torts in Bankruptcy

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AGGREGATION AND ABUSE: MASS TORTS IN BANKRUPTCY

*Edward J. Janger**

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INTRODUCTION

Bankruptcy courts have become the favored forum for large corporate defendants to seek global resolution of mass tort liability claims. Whether this forum choice benefits the victims of those mass torts or facilitates their exploitation is unclear. The features of bankruptcy law that have made bankruptcy court attractive to defendants can be efficiency enhancing, but they can also be used opportunistically and beyond their proper scope. As a result, their use must be subject to safeguards. The good news is that, where torts of the debtor itself are concerned, the U.S. Bankruptcy Code already contains the necessary tools. The bad news is that, in many cases, judges have failed to use them; instead, they have embraced bankruptcy's new role as a "torts court" and have expanded the range of cases they will address and the scope of relief they are willing to grant, not just to the debtor, but to nonbankrupt third parties as well.[1] Although these innovations may help parties reach a global settlement, insufficient attention has been paid to when, and even whether, such relief is appropriate, and courts have frequently let crucial process protections give way to pragmatism.

Bankruptcy courts are not the only federal forum for mass tort cases. Aggregate litigation is possible through class actions and multidistrict litigation (MDL), and both are available without filing for bankruptcy. But several key features have led defendants to invoke the Bankruptcy Code and forum shop into bankruptcy courts: (1) mandatory plaintiff aggregation through plan confirmation or sale, free and clear; (2) defendant aggregation through nonconsensual third-party releases; and (3) bankruptcy à la carte.

Aggregation, when used properly, can facilitate the global resolution of mass tort liability and may facilitate the reorganization of corporate defendants that would otherwise have been forced to liquidate. Nonetheless, this Essay argues that (1) aggregation in bankruptcy court must be linked to the underlying purpose of bankruptcy power (i.e., resolving financial distress); (2) mandatory aggregation is inconsistent with bankruptcy à la carte; and (3) any mandatory third-party relief, if available at all, must be tied to financial distress and be subject to (more) procedural safeguards (than currently exist). The privilege of discharge cannot be disconnected from the prerequisite of financial distress and the Bankruptcy Code's process protections.

Chapter 11 seeks to maximize recovery for creditors and distribute value in a manner that is fair and equitable.[2] It contemplates a multiparty, judicially supervised bargaining process that concludes with a vote.[3] Proponents of the bargain face liquidation if the negotiations fail, and opponents can be bound either by the other members of their class (class acceptance) or by satisfying

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1. For discussions of the Johnson & Johnson talc litigation and the Purdue Pharma opioid litigation, see *infra* Part II.B.2.

2. Professor Melissa B. Jacoby and I have written extensively about the meaning of "equitable" in reorganization cases. *See* Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 TEX. L. REV. 673, 703–07 (2018).

3. 11 U.S.C. §§ 1122, 1125, 1126, 1129(a).

a judicially determined statutory entitlement (cramdown).[4] The negotiation and vote are conducted in the shadow of cramdown—a symmetric statutory death trap in which the recovery of an objecting secured creditor is limited to the value of its collateral, and/or in which objecting classes of unsecured creditors or equity are wiped out unless all senior classes are paid in full. Chapter 11 thereby confers a power not available to most defendants under Federal Rule of Civil Procedure 23 ("Rule 23"): the power to grant the defendant-debtor a discharge over a plaintiff-creditor's objection. Used properly, this power to aggregate (i.e., to bind holdouts) can enhance the recovery of tort claimants and assure fair and equitable treatment. It is only justified, however, by concern that the debtor would otherwise be forced to liquidate. Access to the Bankruptcy Code's powerful tool kit is justified by, but also predicated upon, the financial distress of the debtor. Further, to prevent abuse, compliance with Chapter 11's process protection is a prerequisite to their use. Used improperly, the power to aggregate and discharge can be used as a tactic to coerce settlements, distort distribution, and insulate ill-gotten gains.

Recent cases illustrate the risks. Johnson & Johnson's use of the so-called "Texas Two-Step" to consolidate its talc liability in a single bankrupt subsidiary,[5] and Purdue Pharma's aggressive use of third-party releases,[6] illustrate the dangers associated with using bankruptcy's power to aggregate to coerce settlement. The Bankruptcy Code's plan confirmation process seeks to limit the power of holdouts to act opportunistically. The automatic stay, class acceptance, and the bankruptcy discharge, together, bind individual plaintiffs to the will of the majority. But pursuing global settlement at any price has its own costs. The tools in the Bankruptcy Code that bind nonconsenting parties can be used as a steamroller to supplant individual litigants' cases, to stay pending multidistrict litigation, and to silence objectors to any global settlement. Determining when bargaining is fair, and when an allocation is equitable, is a complicated task—far more complicated and fraught than negotiating a two-party, arm's-length deal. If the procedural protections of Chapter 11 are given short shrift to serve the imperatives of a "deal," the link between value maximization and equity is severed.[7]

This Essay suggests that the possibility of victim exploitation lies not in the Bankruptcy Code per se, but in inattention to the scope of the statutory (and constitutional) bankruptcy power, as well as in what Professor Melissa Jacoby has called "bankruptcy à la carte."[8] Although bankruptcy courts and

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4. 11 U.S.C. § 1129(a) (class acceptance); *id.* § 1129(b) (cramdown).

5. *In re* LTL Mgmt., LLC (*LTL II*), 638 B.R. 291 (Bankr. D.N.J. 2022); *see also infra* Part II.B.2.

6. *See In re* Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021); *see also infra* Part I.C.2.

7. *See generally* Edward J. Janger & Adam J. Levitin, *The Proceduralist Inversion—A Response to Skeel*, 130 YALE L.J.F. 335 (2020).

8. *See* Melissa B. Jacoby, *Shocking Business Bankruptcy Law*, 131 YALE L.J.F. 409, 411 (2021) ("Bankruptcy à la carte extracts the tools of Chapter 11 meant to be available only as part of a package deal and redistributes the benefits."); *see also infra* Part I.C.3.

bankruptcy judges are praised for their pragmatic ability to facilitate the recapitalization of businesses that are in crisis, this pragmatism has sometimes led courts to take procedural shortcuts that sweep away the victim protections built into the Bankruptcy Code and that exceed the boundaries of the bankruptcy power. The problems lie in the failure to honor two key prerequisites to bankruptcy relief: financial distress and process. The takeaway is that a court order binding plaintiffs to a mass tort settlement should not be extorted, either by tactical bullying or with allegations that the debtor is a "melting ice cube."[9] Further, nonconsensual releases should not be granted in the absence of (1) full disclosure of assets, (2) financial distress, and (3) procedural protections provided to claimants by the Bankruptcy Code.

This Essay will proceed in three steps: First, it will canvas current practices with regard to aggregation in mass tort litigation, considering Rule 23, MDL, and Chapter 11. Second, it will consider the doctrinal and normative concerns raised by the tactical use of Chapter 11 in the Johnson & Johnson talc bankruptcy and nonconsensual third-party releases in the opioid case of *In re Purdue Pharma, L.P.*[10] These examples establish the importance of both financial distress and process in Chapter 11 cases. Finally, this Essay will consider whether there might be a benefit to having a mechanism for facilitating resolution of direct claims against related parties. In particular, it will look at the recently proposed UNCITRAL Model Law on Enterprise Group Insolvency[11] to consider whether it offers a viable model.

I. GLOBAL RESOLUTION OF MASS TORTS: RULE 23, MULTIDISTRICT LITIGATION, AND BANKRUPTCY

Mass torts come in many flavors: product liability, environmental claims, employment discrimination, and sexual abuse have been the basis for suits against a single defendant or an industry. Finding ways for the legal system to offer redress, treat plaintiffs fairly, and administer a large portfolio of cases has challenged the state and federal courts for at least four decades. Cases like the Agent Orange product liability case, as well as numerous drug cases, were addressed through class actions under Rule 23 without resorting to bankruptcy.[12] And, where class actions were not appropriate, MDLs sought to procedurally coordinate the various actions and prepare them for trial or settlement. However, both nonbankruptcy fora share a common weakness, at least from the defendants' perspective. It is impossible to bind holdouts to

9. Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcies*, 123 YALE L.J. 862, 865–66, 883 (2014).

10. 635 B.R. 26 (S.D.N.Y. 2021).

11. U.N. COMM'N ON INT'L TRADE L., MODEL LAW ON ENTERPRISE GROUP INSOLVENCY WITH GUIDE TO ENACTMENT, U.N. Sales No. E.20.V.3 (2020), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-11346_mloegi.pdf [https://perma.cc/2BMG-ER38].

12. *See generally* PETER H. SCHUCK, AGENT ORANGE ON TRIAL: MASS TOXIC DISASTERS IN THE COURTS (1987).

a settlement. Although Rule 23 provides for non-opt-out class actions, they are not useful for the vast majority of mass tort cases. The result is that individual claimants have an incentive to hold out for a better deal. Further, neither of these mechanisms can deal with future claims.

Soon after the Bankruptcy Code was enacted, asbestos claims, medical device claims, and environmental claims based on Superfund liability found their way into bankruptcy court.[13] In contrast to Rule 23 class actions, bankruptcy allows a debtor to bind claimants to a plan of reorganization.[14] It is clearly available for claims against the Chapter 11 debtor itself, subject to due process limitations on the power to bind some future claimants.[15] Further, some courts have used Chapter 11's power to release direct claims against related parties.[16] Whether this last practice is desirable or authorized by statute has been front and center in a number of recent cases, and in excellent recent scholarship by Professors Lindsey D. Simon, Samir D. Parikh, Adam J. Levitin, Melissa B. Jacoby, and Ralph Brubaker.[17] Part I describes and evaluates the features of each of these three procedural devices in a bit more detail.

A. *Class Actions*

Plaintiff aggregation through the class action mechanism of Rule 23 was originally considered a mechanism for increasing access to justice for small claims often seeking injunctive relief.[18] Aggregation sought to address the problem of negative-value claims. Torts affect large numbers of people in small ways. Litigation is expensive. In many, if not most, cases, the economic value of seeking redress is not worth less than the individual plaintiff's cost of hiring a lawyer. This is true even where the harm caused, in the aggregate, is large. For small-value claims, legal redress is a collective good.[19] Individual plaintiffs face a collective action problem. As a result, at

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13. *See, e.g.*, Kane v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 843 F.2d 636, 638 (2d Cir. 1988); Grady v. A.H. Robins Co., 839 F.2d 198, 199 (4th Cir. 1988); Signature Combs, Inc. v. United States, 253 F. Supp. 2d 1028, 1029 (W.D. Tenn. 2003).

14. 11 U.S.C. § 1129(a)–(b). It is also possible to sell an asset as a going concern, free and clear of tort claims that would otherwise give rise to successor liability. 11 U.S.C. § 363(f); *In re* Trans World Airlines, Inc., 322 F.3d. 283, 288–91 (3d Cir. 2003); *In re* Leckie Smokeless Coal Co., 99 F.3d 573, 579–82 (4th Cir. 1996). Whether it is appropriate to do this outside the context of a confirmed plan is discussed later in this Essay.

15. 11 U.S.C. § 524(g)–(h); *see also* Epstein v. Off. Comm. of Unsecured Creditors (*In re* Piper Aircraft, Corp.), 58 F.3d 1573, 1576–77 (11th Cir. 1995).

16. For an excellent discussion of the issues surrounding third-party releases, see *In re* Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726 (S.D.N.Y. 2019).

17. *See generally* Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154 (2022); Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. 447 (2022); Adam J. Levitin, Purdue*'s Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. 1079 (2022) [hereinafter Levitin, Purdue*'s Poison Pill*]; Adam J. Levitin, *The Constitutional Problem of Nondebtor Releases in Bankruptcy*, 91 FORDHAM L. REV. 429 (2022); Jacoby, *supra* note 8; Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 YALE L.J.F. 960 (2022).

18. *See generally* OWEN M. FISS, THE CIVIL RIGHTS INJUNCTION (1978).

19. *See* Alexandra D. Lahav, *The Continuum of Aggregation*, 53 GA. L. REV. 1393, 1397 (2019).

least in theory, litigation will be undersupplied and defendants will not internalize the costs of the harm they cause. Rule 23 offers a solution. The class action procedure creates a mechanism for collective representation. Aggregation of claims makes hiring a lawyer cost effective. Even though, in most cases, the claimants could opt out of the settlement,[20] opt-outs are not a problem because the alternative to joining the class is bearing the prohibitive costs of further litigation alone.

1. Positive-Value Claims and Mandatory Aggregation

Not all mass torts involve small claims. An individual claimant with mesothelioma has sufficient damages to make hiring a lawyer economical. For such positive-value claims, the benefits of plaintiff aggregation shift from facilitating the claimant's access to the courts to helping the defendant obtain a global settlement. Indeed, where the defendant is solvent and claimants can hire counsel on a contingent fee basis, plaintiff aggregation provides little benefit to the plaintiffs other than avoiding duplicative attorney effort.

To protect plaintiffs from the downside of aggregation in these cases, Rule 23(e)(4) requires granting dissenting plaintiffs the opportunity to opt out of any proposed settlement. Where the defendant is solvent, MDL and opt-out classes make sense. They can streamline factfinding, facilitate settlement when possible, and leave plaintiffs free to take their chances when it is not. There is no need for mandatory plaintiff aggregation, no matter how much the defendants might want it. Voluntary aggregation should be sufficient.

But defendants want mandatory aggregation a lot. For small-value claims, the cost and uncertainty of individual litigation make additional liability unlikely. But where larger claims are involved, the right to opt out means that, even after a defendant settles a class action, further claims may be brought by plaintiffs going it alone.

2. Rule 23(b)(1)(B) Limited Fund Cases After *Ortiz*: Mandatory Opt-Out

Rule 23 provides three routes to mandatory (non-opt-out) classes. In those cases, a settlement need not offer an opportunity to opt out under Rule 23(3)(e)(4). Two are of limited usefulness for mass tort claimants: Rule 23(b)(1)(A) applies when there is a risk of competing injunctions; Rule 23(b)(2) comes into play when a single act will affect class members in the same way. The third route—the limited fund case—comes into play when class members claim against a common fund or against a liquidating debtor. Rule 23(b)(1)(B) applies where "prosecuting separate actions by or against individual class members would create a risk of . . . adjudications with respect to individual class members that, as a practical matter . . . would substantially impair or impede their ability to protect their interests."[21]

20. FED. R. CIV. P. 23(e)(4).
21. FED. R. CIV. P. 23(b).

The rationale behind creating a compulsory class is that, when the fund is insufficient to pay all of the claims, early claimants may exhaust the pool and leave later claimants with nothing. In such cases, an opt-out right is worthless. Anybody who has not received a distribution before the funds run out will be left out in the cold. A mandatory class assures that everyone with a claim can share equitably, even if they are not happy with the outcome. As will be discussed below, the comparison to bankruptcy is straightforward. When an insolvent defendant is sued, plaintiffs have a similar incentive to try to realize their full claims before the funds run out. The first-in-time nature of litigation results in the potential for inequitable distribution. Indeed, the practical effect of bankruptcy is the same as a limited fund.

Consistent with this rationale, in *Ortiz v. Fibreboard Corp.*,[22] the U.S. Supreme Court limited the availability of Rule 23(b)(1)(B) mandatory settlement classes to cases in which the fund was demonstrably limited—i.e., the defendant or fund was insolvent.[23] In that case, the Court was concerned that the limited nature of the fund was created by the defendant's own actions in entering into a settlement with its insurance companies.[24] The Court held further that, in order to secure a class under Rule 23(b)(1)(B), it needed to be established that the claimants would be treated equitably and all the claimants would be included in the class.[25]

The holding in *Ortiz* thus created two anomalies: (1) because Chapter 11 of the Bankruptcy Code does not require a showing of insolvency, the standard for establishing a limited fund under Rule 23 was now more rigorous than the eligibility requirement for Chapter 11 and (2) if future claimants were likely to come forward, it would not be possible for an ongoing business to address those claims.

B. Multidistrict Litigation

A second approach to mass torts is MDL. The notion behind a multidistrict litigation is that cases involving a single tort are transferred to one federal district court for pretrial procedures and preparation. The aggregation ends there, however, at least in theory. It is contemplated that the cases will be returned to their original jurisdictions for trial. In modern practice, MDLs are often used to create a forum for global settlement. Whether this is an appropriate role for the MDL court has been discussed elsewhere.[26] In any event, the MDL court can only address the claims before it.

22. 527 U.S. 815 (1999).

23. *See id.* at 838–41; *see also* Linda S. Mullenix, *No Exit: Mandatory Class Actions in the New Millennium and the Blurring of Categorical Imperatives*, 2003 U. CHI. LEGAL F. 177, 206–07.

24. *Ortiz*, 527 U.S. at 828–29.

25. *Id.* at 878.

26. *See generally* Parikh, *supra* note 17.

C. Bankruptcy

Bankruptcy offers advantages over both MDL and class actions: a confirmed Chapter 11 plan binds dissenters; a confirmed Chapter 11 plan can address future claims; and, paradoxically, a showing of insolvency is not required to enter Chapter 11.

1. Plaintiff Aggregation: Suits Against the Debtor

Bankruptcy has stepped in where limited fund and MDL cases have declined to go. For forty years, bankruptcy courts have been used to resolve mass tort cases against various debtors. As a practical matter, mandatory aggregation occurs in bankruptcy for the same reason as in a limited fund case: if a debtor liquidates, the claims will be paid out of the resulting fund; and there will be nothing left once the fund is gone.

There is, therefore, a strong family resemblance between a limited fund class action and a bankruptcy.[27] Like the limited fund class action, Chapter 11 of the Bankruptcy Code is designed to address the problem of insolvency. When a debtor liquidates, the outcomes in bankruptcy and a limited fund case are virtually indistinguishable. The debtor's assets are sold, and a fund is created and distributed equitably to the claimants. The difference arises when the firm wishes to continue to operate. Before filing for bankruptcy, a firm in financial difficulty may seek to preserve its going concern value by trying to negotiate a workout agreement. The problem is that the workout will only succeed if all the significant pre-petition claimants agree (including the mass tort claimants). Outside of bankruptcy, a single large plaintiff or group of plaintiffs can pursue their state law remedies and deprive the creditors of the incremental value of reorganization. This is the problem specifically addressed by Chapter 11.

Chapter 11 offers a conceptual innovation. It offers the creditors a choice between alternative sources of recovery: the proceeds of a liquidation or the income stream from the continued operations of the recapitalized debtor. In a Chapter 11 bankruptcy, if the value of the going concern is greater than the value produced by a liquidation, the creditors may elect to be paid out of the income from the debtor's continued operations. The "limited fund" here is the value of the income stream instead of the sales proceeds. When a debtor confirms a plan of reorganization, all claims are channeled into the bankruptcy case and paid out of the income of the reorganized and recapitalized business. The reorganized business receives a discharge.

To preserve this going concern value while negotiating a restructuring, Chapter 11 provides powerful tools for reorganizing the debtor's financial affairs while allowing it to continue its business. These tools address a second coordination problem in the insolvency situation: preserving going concern value. The tool kit includes the automatic stay of all efforts to collect

27. *See generally* S. ELIZABETH GIBSON, CASE STUDIES OF MASS TORT LIMITED FUND CLASS ACTION SETTLEMENTS & BANKRUPTCY REORGANIZATIONS (2000), https://www.uscourts.gov/sites/default/files/masstort_1.pdf [https://perma.cc/636G-M4N9].

on pre-petition debts,[28] the power to operate the business,[29] the power to obtain post-petition financing,[30] and the plan confirmation process, which provides the power to bind dissenting creditors[31] and even to override the objection of a dissenting class of creditors.[32] As will be discussed below, the justification for these extraordinary powers lies in the debtor's financial distress, and they are only available subject to certain safeguards that prevent their abuse.

The justification for allowing an insolvent debtor (including a mass tort defendant) to reorganize in bankruptcy is that it is in the creditors' best interest that the debtor continue its business instead of shutting it down. If the firm liquidates, the value available to the creditors will be limited to the value of the enterprise's assets. By contrast, if the firm continues to operate, and a liquidating trust is funded with stock of the reorganized defendant, or if the business is sold as a going concern, the present and future plaintiffs will benefit from the greater value of the firm's continued operations, either as owners or because that value was embodied in the sales price paid by the purchasers. For mass tort claimants, therefore, present and future claims can be provided for by creating a trust funded with stock and or debt of the reorganized defendant.

In asbestos cases, Congress expressly validated this use of bankruptcy to discharge pre-petition tort claims for both present and future claimants.[33] Initially, there was some dispute as to whether such relief was available to non-asbestos defendants. The dispute focused on the definition of "claim" in 11 U.S.C. § 101(5) as a "right to payment."[34] Most circuits that addressed the issue concluded that the "right to payment" arose when the tortious "conduct" occurred,[35] so long as there was a pre-filing relationship between the plaintiff and the defendant.[36] Until 2010, however, the U.S. Court of Appeals for the Third Circuit disagreed, stating in *In re M. Frenville Co.*[37] that the "right to payment" did not arise until the claim would have accrued under tort law.[38] Since then, a consensus has emerged among the U.S. Circuit Courts of Appeals that, at least where the debtor itself is concerned, present and future claims can be discharged in bankruptcy.[39] Indeed, even *Frenville* was overruled by the Third Circuit in *Jeld-Wen, Inc. v. Van Brunt (In re*

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28. 11 U.S.C. § 362.
29. *Id.* §§ 363, 1108.
30. *Id.* § 364.
31. *Id.* §§ 1126, 1129(a).
32. *Id.* § 1129(b).
33. *Id.* § 524 (g).
34. *Id.* § 101(5).
35. *See, e.g.*, Grady v. A.H. Robins Co., 839 F.2d 198, 202–03 (4th Cir. 1988); Jeld-Wen, Inc. v. Van Brunt (*In re* Grossman's Inc.), 607 F.3d 114 (3d Cir. 2010).
36. *See, e.g.*, Epstein v. Off. Comm. of Unsecured Creditors (*In re* Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995).
37. 744 F.2d 332 (3d Cir. 1984), *overruled by* Jeld-Wen, Inc. v. Van Brunt (*In re* Grossman's Inc.), 607 F.3d 114 (3d Cir. 2010).
38. *Id.* at 337.
39. 11 U.S.C. § 101(5); *see In re Grossman's Inc.*, 607 F.3d at 125.

Grossman's Inc.),[40] which followed the "conduct" approach articulated in *Grady v. A.H. Robins Co.*[41] Further, the ability to discharge future claims runs to the limits of constitutional due process.[42] This ability to discharge future claims in bankruptcy makes bankruptcy even more attractive than a class action. It allows compulsory plaintiff aggregation and permits the debtor to provide for future claims. Used properly, this power benefits both the business and the claimants.

These Chapter 11 superpowers do not come for free. Chapter 11 is a carefully calibrated statutory package that uses both procedural and substantive protections to assure equity in resolving financial distress. An essential aspect of the justification for compulsory plaintiff aggregation is that the debtor has filed for bankruptcy and therefore must comply with the Bankruptcy Code's requirements of disclosure, solicitation, voting, good faith, fairness, and equity. To wit, (1) the court must determine that the Chapter 11 process is being used for a legitimate bankruptcy purpose (i.e., to resolve financial distress and not as a tactic),[43] (2) the debtor must commit all of its assets for the payment of claims,[44] (3) the creditors must be given adequate information about those assets,[45] (4) the creditors trade a veto for a voice in how that value is allocated,[46] and (5) objectors are guaranteed fair and equitable treatment.[47]

Although there is much room in the bankruptcy process for pragmatism, courts overlook these protections at their peril. As discussed below, financial distress remains important.[48] When used solely as a litigation tactic by the debtor, the justification for mandatory aggregation disappears. Similarly, the rationale disappears when direct claims against solvent third parties are involved, even if they arise out of the same facts and circumstances as the debtor's liability. These potential abuses are laid bare when, as in the Johnson & Johnson case, a solvent entity uses a strategic corporate transaction to sequester liabilities in a subsidiary and then causes it to file for bankruptcy,[49] and when, as in *In re Purdue Pharma*, the power is extended to grant nonconsensual releases to third parties who have not submitted to the jurisdiction of the bankruptcy court, and the corporation has conceded that it has intentionally placed assets beyond the reach of creditors.[50]

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40. 607 F.3d 114 (3d Cir. 2010).

41. 839 F.2d 198 (4th Cir. 1988).

42. *See generally* Kaiser Aerospace & Elecs. Corp. v. Teledyne Indus., Inc. (*In re* Piper Aircraft Corp.), 244 F.3d 1289 (11th Cir. 2001).

43. *See infra* Part II.B.2.

44. 11 U.S.C. § 541.

45. *Id.* § 1125.

46. *Id.* § 1126.

47. *Id.* § 1129(a)(7), (b).

48. *See infra* Part III.

49. *See infra* Part II.B.2.

50. *See generally In re* Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021). On appeal, Judge Colleen McMahon quoted the bankruptcy judge, who, in approving the proposed plan of reorganization, stated in full:

> The record suggest[s] that at least some of the Sacklers were very aware of the risk of opioid-related litigation claims against Purdue and sought to shield themselves

2. Defendant Aggregation: Suits Against Related Parties

Sometimes, addressing claims, even future claims, against the debtor is not enough to achieve global peace; third-party (nondebtor) releases may also be sought.[51] As with the discharge of future claims, third-party releases are expressly provided for in asbestos cases, but not in non-asbestos cases.[52] Although a consensus developed that the definition of "claim" includes future claims against the debtor and made them available beyond asbestos cases,[53] no such consensus has emerged for third-party releases. Bankruptcy and appellate courts remain divided on whether to grant them.[54]

This has led defendant-debtors to forum shop into courts that do grant such releases.[55] The most prominent recent example of this practice can be found in the Purdue Pharma bankruptcy. Purdue is the manufacturer of the powerful opiate Oxycontin.[56] It is a defendant in thousands of cases brought by both individuals and state attorneys general, many of which were consolidated into an MDL.[57] The problem was that, during the years running up to the bankruptcy, the Sackler family that controlled and owned the company had reaped billions of dollars in dividends.[58] The biggest asset of Purdue's bankruptcy estate was the potential liability of members of the Sackler family who received those dividends. But the Purdue estate was not the only entity with claims against the Sackler family. Many opioid plaintiffs also asserted direct claims against Sackler family members. Any global settlement, it was believed, would need to address both the direct and indirect claims against family members.[59]

Although there is no reason that the Purdue estate could not settle its claims against these third parties as part of its plan, whether that plan could also provide a mandatory discharge of the direct claims of opioid claimants against those defendants was a different matter. They might join the settlement voluntarily, but there was no obvious power to compel them to participate. Further, the Sacklers were not in bankruptcy themselves, and there was no allegation that they were or would be rendered insolvent. So, the limited fund/financial distress rationale for mandatory aggregation was

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> from the economic effect of such claims by causing Purdue to make billions of dollars of transfers to them and to shield their own assets, as well, from collection.

Id. at 57 (alteration in original) (quoting *In re* Purdue Pharma, L.P., 633 B.R. 53, 92 (Bankr. S.D.N.Y. 2021), *vacated*, 635 B.R. 26 (S.D.N.Y. 2021)).

51. *See, e.g.*, Gibson, *supra* note 27, at 236 (noting the presence of related-party releases in the Dow Corning plan of reorganization).

52. 11 U.S.C. § 524(g)(2), (4).

53. *See supra* note 39 and accompanying text.

54. *See generally* SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (*In re* Seaside Eng'g & Surveying, Inc.), 780 F.3d 1070 (11th Cir. 2015); Nat'l Heritage Found., Inc. v. Highbourne Found., 760 F.3d 344 (4th Cir. 2014); Levitin, Purdue*'s Poison Pill*, *supra* note 17, at 1105–06.

55. Levitin, Purdue*'s Poison Pill*, supra note 17, at 1128.

56. *In re* Purdue Pharma, L.P., 635 B.R. 26, 34 (S.D.N.Y. 2021).

57. *Id.* at 34–35, 49, 51–52.

58. *See id.* at 55–58.

59. *See id.* at 89–115.

missing.[60] Indeed, the sole argument for compelling a release of direct claims was that it was a condition demanded by the Sacklers.[61] As was noted in both the bankruptcy court's confirmation order and the district court's reversal of that order, the assets of the family were held in such complex ways and in such hard-to-find places that pursuing them would be prohibitively expensive.[62] Negotiations resulted in a significant offer from the Sackler family to contribute to the estate, but a condition of the contribution was a global release of numerous related parties.[63]

The requisite majorities approved the reorganization plan, but a number of claimants, particularly state attorneys general who were asserting direct claims against the Sackler family, objected to the releases.[64] The Purdue Pharma case is still unfolding. On appeal, the district court reversed the plan confirmation, holding that the bankruptcy court did not have the power to grant the release of direct claims.[65] That ruling itself is on appeal.[66] Meanwhile, the issue of third-party releases is prominent in, for example, the USA Gymnastics bankruptcy[67] and the Boy Scouts bankruptcy.[68]

Professors Ralph Brubaker, Melissa Jacoby, Adam Levitin, Samir Parikh, and Lindsey Simon have all written on these third-party releases.[69] Professors Simon and Parikh offer potential statutory amendments to regulate when such releases would be available.[70] Professors Brubaker and Levitin suggest that they are beyond the power of the courts.[71] Professor Jacoby focuses on the tendency of bankruptcy courts to fall victim to what

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60. *See generally id.*

61. *See id.* at 90.

62. *See id.* at 36; *In re* Purdue Pharma, L.P., 633 B.R. 53, 88–89 (Bankr. S.D.N.Y. 2021), *vacated*, 635 B.R. 26 (S.D.N.Y. 2021).

63. *See In re Purdue Pharma*, 635 B.R. at 63–65.

64. *See id.* at 65–77.

65. *See id.* at 115.

66. *See* Dietrich Knauth, *Purdue Pharma Bankruptcy Mediator Says Sacklers, US States Closer to Deal over Opioid Claims*, REUTERS (Feb. 8, 2022, 5:09 PM), https://www.reuters.com/business/healthcare-pharmaceuticals/mediator-purdue-pharma-bankruptcy-seeks-extend-talks-feb-16-2022-02-08/ [https://perma.cc/9NXG-MBP6]. After intense mediation, a settlement was reached with the objecting attorneys general, under which the Sacklers agreed to contribute over one billion dollars above their original proposed contribution to the plan of reorganization. *Sackler Family Agrees to Pay $6 Billion in New Opioid Settlement Between Purdue Pharma and States*, CNBC (Mar. 3, 2022, 11:43 AM), https://www.cnbc.com/2022/03/03/purdue-pharma-us-states-agree-to-new-opioid-settlement.html [https://perma.cc/4RGE-ZP7L].

67. *See Settlement with Survivors Approved by Court; USA Gymnastics to Exit Bankruptcy*, USA GYMNASTICS (Dec. 13, 2021), https://usagym.org/pages/post.html?PostID=26844 [https://perma.cc/ZPJ8-BW8B]; Alex Wolf, *USA Gymnastics' $380 Million Bankruptcy Plan Gets Approval*, BLOOMBERG L. (Dec. 13, 2021, 4:36 PM), https://news.bloomberglaw.com/bankruptcy-law/usa-gymnastics-380-million-bankruptcy-plan-set-for-approval [https://perma.cc/2PM8-TBRT].

68. Cara Kelly, *Boy Scouts of America Bankruptcy Update: Key Agreement Reached Ahead of Confirmation Hearing*, USA TODAY (Feb. 10, 2022, 12:37 PM), https://www.usatoday.com/story/news/investigations/2021/12/15/boy-scouts-bankruptcy-update-what-know-settlements-more/6439683001/ [https://perma.cc/4Q3W-KBMZ].

69. *See supra* note 17 and accompanying text.

70. *See* Simon, *supra* note 17, at 1205–15; Parikh, *supra* note 17, at Part V.B.2.

71. *See* Brubaker, *supra* note 17, at 966–80.

might be called "crisis pragmatism."[72] They are bullied by the parties into distortions of the bankruptcy process, in the service of global peace. I join Professor Jacoby in concluding that involuntary releases of claims against the debtor must only be available if the parties comply with the plan process and should not be available in cases involving all-asset sales conducted without the protections of the plan process. Professors Levitin, Jacoby, and Brubaker would take third-party releases of direct claims off the table.[73] I agree with them that they are not within the contemplation of the current bankruptcy statute. However, I consider whether there is a need for such a device and how it might be constructed.

3. Bankruptcy à la Carte

Perhaps the greatest attraction of the bankruptcy forum is a bug masquerading as a feature. Bankruptcy courts and bankruptcy judges take pride in their pragmatism and ability to arrive at creative solutions to restructuring problems. Bankruptcy lawyers take this pride even a bit further. As Professor Jacoby and I have explained in prior work, debtors and their attorneys often use financial exigency as a mechanism to hold the bankruptcy goal of value maximization hostage against the other bankruptcy goals of process and fairness.[74] Most recently, Professor Jacoby wrote provocatively in her article, *Shocking Bankruptcy Law*, that emergency is the enemy of process, and that attorneys are very good at creating, or portraying, such emergencies.[75]

The Bankruptcy Code envisions a party-driven, court-supervised process of bargaining over restructuring that serves multiple purposes. On the one hand, it seeks value maximization. But, at the same time, it also seeks transparency, participation, and fair distribution of value. To accomplish this, the code envisions an exit from bankruptcy through a plan that is negotiated between the debtor and the various creditor constituencies, that is voted on after disclosure of information, that is approved by the court (so long as all classes vote to accept), and that satisfies certain statutory prerequisites. If not all classes accept, the plan may still be confirmed, but only if certain entitlement thresholds are satisfied.[76]

Notwithstanding this statutory structure, creative attorneys have found ways to work around this process. This can be accomplished either by selling the business as a going concern prior to the confirmation process or by prepackaging or prenegotiating a deal using coercive restructuring support

72. *See generally* Jacoby, *supra* note 8.
73. *See generally* Levitin, Purdue*'s Poison Pill*, *supra* note 17; Jacoby, *supra* note 8; Brubaker, *supra* note 17.
74. *See generally* Jacoby & Janger, *supra* note 2.
75. *See* Jacoby, *supra* note 8, at 411.
76. *See* Brubaker, *supra* note 17, at 986–87; *cf.* Levitin, Purdue*'s Poison Pill*, *supra* note 17, at 1147–48, 1153 n.318 (questioning constitutionality).

agreements, all of which determine the result of the case before it even begins.[77]

The discussion above shows why bankruptcy courts are now a favorite forum for defendants who wish to cap their tort liability and move on with their businesses. Whether this use of bankruptcy benefits or harms claimants is an open question, as is the question of whether current practice is consistent with the statute itself.[78]

II. AUTHORIZATION AND DESIRABILITY: THE BANKRUPTCY DEAL

There are two primary considerations regarding the promise and risk of Chapter 11 for resolving mass torts: (1) what does bankruptcy law allow concerning claims against the debtor and third parties, and (2) what are the procedural preconditions for relief? There is an important symmetry between Rule 23 and Chapter 11. In both cases, a precondition to mandatory plaintiff aggregation is an inability to satisfy claims using existing financial resources. Also, both Rule 23 and Chapter 11 place procedural limits on settlements to ensure notice, opportunity to participate, and assessment of the fairness of any distribution. In both cases, the prerequisite to aggregation is insolvency and process.

A. Authorization

The discussion above explains how the power to aggregate and release claims against a debtor flows naturally from the fact that the Bankruptcy Code's broad definition of "claim" includes "right[s] to payment" that arise from "conduct" that occurred pre-petition, so long as there is a "relationship" between the plaintiff and the debtor sufficient to satisfy the requirements of due process.[79] The power to grant a nonconsensual release against a third party is an entirely different question; there is nothing in the Bankruptcy Code expressly authorizing it.

The statutory basis for nonconsensual third-party releases, if there is one, can be found in the broad statement in 11 U.S.C. § 105 that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[80] This language is generally understood to grant the bankruptcy court equity power. Two relatively common (albeit somewhat controversial) uses of § 105 are "paying the trade" and granting a "supplemental stay."

As Professor Brubaker points out, that grant of power provided a new home for the so-called doctrine of "necessity" that existed under the

77. *See* Edward J. Janger & Adam J. Levitin, *Badges of Opportunism: Principles for Policing Restructuring Support Agreements*, 13 BROOK. J. CORP. FIN. & COM. L. 169 (2018).

78. *See infra* Part II.

79. *See* 11 U.S.C. § 101(5); Jeld-Wen, Inc. v. Van Brunt (*In re* Grossman's Inc.), 607 F.3d 114, 122 (3d Cir. 2010); Kaiser Aerospace & Elecs. Corp. v. Teledyne Indus., Inc. (*In re* Piper Aircraft Corp.), 244 F.3d 1289, 1039 (11th Cir. 2001).

80. 11 U.S.C. § 105(a).

Bankruptcy Act of 1898.[81] Over time, the doctrine of necessity has been used to justify a wide variety of practices that are deemed "necessary" to bring the case to a successful conclusion. One example is paying the trade—allowing post-petition payments of pre-petition debt to certain creditors when doing so is in the interest of the estate. Here, in order to keep the business going for all the creditors, courts have allowed the debtor to leave their commercial relationships with suppliers and customers unimpaired.[82]

The most important, and relevant, use of the equity power granted by § 105 is the so-called supplemental stay. The automatic stay, provided for by § 362, stops creditors from seeking to collect on their debt during the pendency of the case. Sometimes, however, creditors may seek to place pressure on the debtor by pursuing related parties such as the owners, or affiliates who are not in bankruptcy. The Supreme Court has held that these actions are within the bankruptcy court's "related to" jurisdiction and have granted an extension of the automatic stay to preserve the viability of the debtor and the reorganization.[83]

From here, it might seem a short leap to the third-party release, but it is not. Both the automatic stay and the supplemental stay are temporary measures designed to preserve value, pending final allocation. Courts that have issued these supplemental stays have noted that the supplemental stay is free from the asset protection that goes along with a formal filing. These courts have imposed restrictions on asset transfers by the beneficiaries of the stay and have required adequate protection payments to prevent abuse and mirror the protections inherent in the automatic stay itself.[84] Crucially, the supplemental stay and even the payment of critical vendors are justified by the need to preserve the status quo and preserve the possibility of a reorganization. They do not finally adjudicate rights (or, at least, they are not supposed to).

Unlike paying the trade or the supplemental stay, third-party releases constitute permanent relief. The discharge injunction is permanent, as are the releases. Therefore, the creditors' claims against the third parties are permanently extinguished. This does not preserve the status quo; it fundamentally alters it. Further, there are two existing legislative provisions that determine when mandatory aggregation is possible—Rule 23 and § 1129 of the Bankruptcy Code.[85] To create such a device out of whole cloth seems a bit of a reach. More importantly, if it is to be created using the bankruptcy court's equity power, the use must be equitable, which is to say that whatever

81. Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978); *see* Brubaker, *supra* note 17, at 968.

82. *Compare In re* Just for Feet, Inc., 242 B.R. 821, 824–26 (D. Del. 1999), *with In re* Kmart Corp., 359 F.3d 866, 874–75 (7th Cir. 2004), *and* Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11 Cases*, 47 B.C. L. REV. 183 (2005).

83. *See generally* Celotex Corp. v. Edwards, 514 U.S. 300 (1995); A.H. Robins Co. v. Piccinin, 788 F.2d 994 (4th Cir. 1986).

84. *See, e.g.*, *In re* F.T.L., Inc., 152 B.R. 61, 63 (Bankr. E.D. Va. 1993).

85. FED. R. CIV. P. 23; 11 U.S.C. § 1129.

procedures are followed, they must mirror the protections provided to creditors by the Bankruptcy Code. In short, what is authorized is linked inextricably to the procedural protections mandated by the Bankruptcy Code.

B. Insolvency vs. Tactics

A key aspect of both Rule 23(b)(1)(B) and Chapter 11 is that they conceptually address the problem of an insolvent fund. A peculiarity of Chapter 11, when compared to bankruptcy codes in other countries, is that it does not require the debtor to be insolvent to seek relief. It only requires a "good faith" bankruptcy purpose.[86] This is usually taken to mean that the filing is being used to resolve some form of financial distress. This is less rigorous than the requirement for a limited fund class action under Rule 23. It is also a peculiarity of U.S. law.[87] Most other national bankruptcy systems *do* require the debtor to establish its insolvency. A precondition for debt relief is an inability to pay. Also, unlike the U.S. bankruptcy system, most countries would require an insolvent firm to enter insolvency proceedings.[88] Failure to do so creates possible liability for the officers and directors.

1. Insolvency and Good Faith

There is an important cultural reason for this feature of the U.S. system. The U.S. system is oriented toward rehabilitating the firm and preserving its going concern value. In many countries, the insolvency requirement is viewed as a recognition that the game is over. It begins the process of winding up the business. The Chapter 11 approach de-emphasizes the opening of the proceeding in the hope that the business will continue operating. So, instead of arguing over whether a debtor is insolvent, courts focus on the more amorphous question of whether the case is filed in good faith.

This issue has been front and center in mass tort cases for decades. When Johns-Manville filed for bankruptcy in 1981, critics claimed that it was not insolvent, and the firm itself emphasized that it planned to remain in business. As one contemporary commentator put it:

> After all is said and done, the central issue in this case for most people is not that Manville is filing for Chapter 11 to avoid immediate and future liability, but that Manville is alive, doing well, highly solvent and not even close to closing up shop and yet it is filing for bankruptcy! Manville claims that just because their actions are unprecedented (save for UNR) and highly unorthodox, it does not follow that they are acting in an immoral or illegal fashion. Manville officials insist that filing for bankruptcy was unavoidable and in the best interest of its stockholders, employees and

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86. *See In re* SGL Carbon Corp., 200 F.3d 154, 160–62 (3d Cir. 1999).
87. *Cf., e.g.*, Insolvency Act 1986, c. 45, § 283(K)(1)(b) (U.K.) (requiring the debtor to be unable to pay their debts before receiving a bankruptcy order).
88. *See id.*

> creditors. Moreover, they feel that in the long run their decision will better benefit the victims of asbestos related diseases.[89]

The Manville case went forward because there were serious concerns about the company's ability to honor all the ongoing asbestos claims while staying in business.[90]

By contrast, there have been at least two scenarios where bad faith was found: (1) when the bankruptcy is being used as a "tactic" in litigation and (2) when there is no realistic chance of reorganization, and the bankruptcy is just being used to buy time. *In re SGL Carbon*[91] is an example of the first type of case. There, a debtor filed for bankruptcy to deal solely with the issue of potential treble damages in an antitrust case; the bankruptcy was deemed to be not in good faith, but merely a "litigation tactic."[92] As a result, the Third Circuit reversed the district court's decision to deny the defendants' motions to dismiss.[93]

The second category is illustrated principally by so-called "single-asset" real estate cases. A typical single-asset real estate case involves the bankruptcy of a real estate limited partnership that holds only one asset and has only one creditor. The asset is the building. Its value is determined by the present value of the cash flow generated by the rent roll, and its only significant creditor is the partnership's mortgage lender. In these cases, there is nothing to reorganize. It is a two-party negotiation, and bankruptcy is being used solely as a tactic to delay the state law foreclosure. The answer might be different if there were multiple creditors and coordination problems, or if there was reason to believe that the value of the property might rebound. But in the absence of these factors, there is nothing that federal bankruptcy law provides that could not be guaranteed by the state's foreclosure regime.[94]

2. Tactics and Opportunism

Two recent examples, however, demonstrate bankruptcy courts' recent sensitivity to being used by parties for tactical advantage.

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89. A.R. Gini, *MANVILLE: The Ethics of Economic Efficiency?*, 3 J. BUS. ETHICS 63, 68 (1984).

90. *See id.* at 65–66.

91. 200 F.3d 154 (3d Cir. 1999).

92. *Id.* at 167 ("[O]fficers expressly and repeatedly acknowledged Chapter 11 petition was filed *solely* to gain tactical litigation advantages.").

93. *Id.* at 169.

94. *See In re* JER/Jameson Mezz Borrower II, LLC, 461 B.R. 293, 298 (Bankr. D. Del. 2011) ("[T]he burden is on the Debtors to establish that they filed their petitions in good faith to preserve the Debtors' going concern value or to maximize the value of the Debtors' estate, rather than as a litigation tactic."); *In re* Primestone Inv. Partners L.P., 272 B.R. 554, 557 (D. Del. 2002) (providing additional factors that courts consider in single-asset real estate bankruptcy cases); *In re* Energy Future Holdings Corp., 561 B.R. 630, 639–40 (Bankr. D. Del. 2016) ("A party filing for Chapter 11 bankruptcy may prove that its petition served a valid bankruptcy purpose by showing that the petition 'preserved a going concern or maximized the value of the debtor's estate . . . .' Courts demand more than the desire to stay pending litigation with the automatic stay.").

The most brazen is, of course, the National Rifle Association's (NRA) attempt to file for bankruptcy in Texas.[95] The NRA is a nonprofit incorporated in New York.[96] It came under investigation by the attorney general of New York State, Letitia James, for misuse of organizational funds.[97] The NRA sought to reincorporate in Texas and promptly filed for bankruptcy there.[98] This filing was made despite the fact that there was no suggestion that the organization was short of funds.[99] After a ten-day hearing, the bankruptcy judge dismissed the case as filed in bad faith, stating:

> The Court believes the NRA's purpose in filing bankruptcy is less like a traditional bankruptcy case in which a debtor is faced with financial difficulties or a judgment that it cannot satisfy and more like cases in which courts have found bankruptcy was filed to gain an unfair advantage in litigation or to avoid a regulatory scheme.[100]

The second case involved Johnson & Johnson's (J&J) talc liabilities.[101] J&J, which is based in New Jersey, faced a large number of suits alleging that use of its talcum powder increased the risk of ovarian cancer and mesothelioma.[102] Initially, they litigated these cases and won, but after losing a few, J&J swung into action. Nobody seems to seriously think that the talc liability threatens the solvency, or even the liquidity, of the corporate giant.[103] Nonetheless, to deal with these talc liabilities, J&J took advantage of a Texas statute to engage in a tactic called a divisive merger.[104] It divided old J&J in two and shifted the talc liabilities to the new subsidiary, LTL Management, LLC, and funded the entity with assets allocated to cover the talc liability, along with an agreement to provide funding.[105] LTL Management then reincorporated in North Carolina and filed for Chapter 11, and the remaining entities reincorporated in New Jersey, where J&J is based (and where the talc suits are currently pending).[106] Apparently, North Carolina was chosen because the U.S. Court of Appeals for the Fourth Circuit has a particularly strict standard for dismissal based on bad-faith filing.[107]

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95. *See In re* Nat'l Rifle Ass'n of Am., 628 B.R. 262 (Bankr. N.D. Tex. 2021).
96. *Id.* at 264.
97. *Id.* at 264, 265–66.
98. *Id.* at 267–68.
99. *Id.* at 275.
100. *Id.* at 281.
101. *See* LTL II, 638 B.R. 291 (Bankr. D.N.J. 2022).
102. *See id.* at 297.
103. J&J is ranked thirty-seventh on the 2022 Fortune 500 list of companies. *Fortune 500*, FORTUNE, https://fortune.com/fortune500/2022/ [https://perma.cc/EZ55-SAVN] (last visited Oct. 7, 2022); *cf. In re* LTL Mgmt., LLC (*LTL I*), No. 21-30589, 2021 WL 5343945, at *1 (Bankr. W.D.N.C. Nov. 16, 2021) (suggesting that the bankruptcy was only meant to resolve the talc liability, stating "[t]he Debtor [LTL Management, LLC] maintains this restructuring was undertaken to enable the Debtor to fully resolve talc-related claims through a chapter 11 reorganization without subjecting the entire J&J enterprise to a bankruptcy proceeding").
104. TEX. BUS. ORGS. CODE ANN. §§ 10.001–10.010 (West 2021); *see LTL II*, 638 B.R. at 304, 322.
105. *LTL II*, 638 B.R. at 297.
106. *LTL I*, 2021 WL 5343945, at *1.
107. *See, e.g.*, Carolin Corp. v. Miller, 886 F.2d 693, 700–01 (4th Cir. 1989) (requiring a showing of subjective bad faith). Indeed, in *In re Bestwall LLC*, a U.S. Bankruptcy Court in

This first part of the strategy did not work out as J&J had planned. Although the U.S. Bankruptcy Court for the Western District of North Carolina did not decide the question of bad faith per se, the court did question the merger, at least insofar as to question why it was filed in North Carolina, and concluded that venue was improper.[108] The court pointed out that J&J and LTL Management were both located in New Jersey, not Texas or North Carolina, and accordingly sent the case to the U.S. District Court for the District of New Jersey[109] to handle the case, including the question of bad-faith filing.[110]

There are many reasons to be dubious about the J&J bankruptcy strategy. First, it is not clear that the divisive merger will effectively shield J&J's assets from liability. Both Texas and the Bankruptcy Code provide for the avoidance of fraudulent transfers.[111] Fraudulent transfers include any transfer made with the intent to hinder, delay, or defraud creditors.[112] Although the Texas divisive-merger statute seeks to exclude divisive mergers from avoidance, stating that entities may merge without any transfer having occurred,[113] § 548 of the Bankruptcy Code—and the Bankruptcy Code's definition of "transfer"—would still apply, regardless of whether the debtor was insulated under state law.[114]

The merger left LTL Management, the talc entity, with $373 million in assets and a two-billion-dollar insurance fund, while facing billions of dollars in potential liability.[115] This structure presents the talc claimants with an unpleasant choice: allow J&J to cap its liability or pursue messy fraudulent transfer litigation in the bankruptcy case. As such, the merger and the filing are tactical, even if, in theory, they do not change the substance of the debtor's liability because of the funding agreement. Particularly if J&J has the wherewithal to meet its talc liabilities, the divisive merger and bankruptcy was merely a tactic.

The status of the J&J case is uncertain at the moment. In February 2022, Judge Michael B. Kaplan declined to dismiss the case as filed in bad faith.[116] He took the view that bankruptcy court was, generally speaking, a favorable

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the Western District of North Carolina declined to dismiss a case filed after a divisive merger as a bad-faith filing. 605 B.R. 43 (Bankr. W.D.N.C. 2019).

108. The bankruptcy court in *LTL I* suggested that the strict standard for dismissal in the Fourth Circuit motivated LTL Management's incorporation in North Carolina. *See LTL I*, 2021 WL 5343945, at *6 ("Rather, the Debtor's actions indicate a preference to file bankruptcy in this district, likely due to the Fourth Circuit's two-prong dismissal standard . . . .").

109. *See id.* at *7.

110. *See In re* Rent-A-Wreck of Am., Inc., 596 B.R. 122 (Bankr. D. Del. 2019) (requiring a valid bankruptcy purpose that does not simply seek a tactical advantage).

111. TEX. BUS. & COM. CODE ANN. § 24.001–24.013 (West 2021) (Uniform Fraudulent Transfer Act); 11 U.S.C. § 548(a)(1).

112. BUS. & COM. § 24.005; 11 U.S.C. § 548.

113. TEX. BUS. ORGS. CODE ANN. § 10.008(2)(C) (West 2021).

114. 11 U.S.C. §§ 101(54), 548.

115. *In re* LTL Mgmt., LLC (*LTL III*), 637 B.R. 396, 401 (Bankr. D.N.J. 2022).

116. *Id.* at 429–30.

and appropriate—and, indeed, superior—forum for addressing mass tort liability:

> What the Court regards as folly is the contention that the tort system offers the *only fair and just pathway* of redress and that other alternatives should simply fall by the wayside. It is manifestly evident that Congress did not share this narrow view in developing the structure of asbestos trusts under § 524(g). There is nothing to fear in the migration of tort litigation out of the tort system and into the bankruptcy system. Rather, this Court regards the chapter 11 process as a meaningful opportunity for justice, which can produce comprehensive, equitable, and timely recoveries for injured parties. The bankruptcy courts offer a unique opportunity to compel the participation of all parties in interest (insurers, retailers, distributors, claimants, as well as Debtor and its affiliates) in a single forum with an aim of reaching a viable and fair settlement.[117]

The case is currently on appeal to the Third Circuit.[118]

Since the bankruptcy court's decision on LTL Management, another court has addressed a similar issue. 3M was faced with tort litigation brought by military veterans allegedly injured by faulty earplugs. Instead of using the Texas Two-Step, 3M used an existing subsidiary in a manner that had the same effect as a divisive merger. Although the court allowed the subsidiary's bankruptcy to proceed, the bankruptcy court declined to grant a supplemental stay that would have protected 3M from liability during the pendency of the subsidiary's bankruptcy case.[119] That ruling, too, is on appeal.[120]

These cases demonstrate that the question of what constitutes a good-faith bankruptcy filing is very much in play in the mass torts context. Mass tort defendants are flocking to bankruptcy court to make use of the Chapter 11 tool kit for aggregating plaintiffs, protecting co-defendants, and obtaining global peace. The tools are indeed powerful. Questions remain: What are the justifications for these bankruptcy superpowers? And what are the prerequisites for their use?

C. Process and Pragmatism

Both Chapter 11 and Rule 23 recognize that when one is binding a dissenter, it is crucial to identify the justification for overriding their objection. Further, it is essential to assure that they are being treated fairly, that all of the available assets of the debtor are being committed to payment of debt, and that the value being distributed is being distributed equitably.

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117. *Id.* at 414.

118. Justin M. Mertz, *3rd Circuit to Rule on the Validity of the "Texas Two-Step" in Chapter 11 Cases*, LEXOLOGY (Sept. 21, 2022), https://www.lexology.com/library/detail.aspx?g=c9f867ee-9c12-419c-ad12-56f8cec60c7d [https://perma.cc/WRZ9-N9W8].

119. *In re* Aearo Techs. LLC, No. 22-02890, 2022 WL 3756537, at *16 (Bankr. S.D. Ind. Aug. 26, 2022).

120. Jonathan Randles & Bob Tita, *3M's Bankruptcy Setback Deepens Earplug Litigation Troubles*, WALL ST. J. (Aug. 31, 2022, 7:10 PM), https://www.wsj.com/articles/3ms-bankruptcy-setback-deepens-earplug-litigation-troubles-11661976054 [https://perma.cc/C8KK-XQT9].

A Chapter 11 plan of reorganization cannot be confirmed without (1) adequate disclosure; (2) majority support of the plan by all impaired classes; (3) demonstration that the plan gives the claimants more than they would receive going it alone; and, (4) if a class of creditors objects, that junior interests (the old owners) will be wiped out.

Professor Jacoby and I, together and separately, have explored how creative lawyers have used all asset sales, prepacks, and the perceived need for speed to convince judges to forego some of the processes described above.[121] Professor Jacoby has made this point forcefully in her masterful essay, *Shocking Business Bankruptcy Law*, where she calls this practice "bankruptcy à la carte."[122] Bankruptcy à la carte describes how tools developed to preserve the value of a firm during a restructuring can be and are deployed opportunistically, without procedural protection, to benefit those in control of the case or to clear away an opponent with a veto.[123] A mistake frequently made in bankruptcy practice is assuming that process can be foregone if it will interfere with the successful consummation of a deal. For example, Professor David A. Skeel, Jr. defends certain distortions of the voting process in his recent article, *Distorted Choice in Corporate Bankruptcy.*[124] The problem, demonstrated by cases too plentiful to list, is that this is a slippery slope.[125] Professor Adam Levitin and I have registered our disagreement.[126] Bankruptcy courts have an extraordinary power to discharge debts, while granting juridic entities continued life. Compliance with process is the price of that power.[127]

III. THE TAKEAWAY AND A PROPOSAL

The discussion above suggests that the use of bankruptcy to address mass torts raises two distinct sets of problems. The first set relates to aggregation of claims against the debtor itself, and the second set relates to third-party releases. When a debtor seeks to address mass tort claims, the requirement of good faith suggests that the reason for turning to bankruptcy is because of a legitimate concern about the debtor's ability to satisfy its tort liability. If that is the case, the risk comes not from the possibility of a channeling injunction or mandatory aggregation, but from insolvency itself. The concern, then, is not escaping liability but preserving available value and allocating available funds equitably. Channeling serves both the function of value preservation and equitable distribution. That said, there is a procedural quid pro quo for bankruptcy relief. All assets must be disclosed and contributed to the reorganization. Voting procedures must be adhered to, and

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121. *See generally* Jacoby & Janger, *supra* note 2; Jacoby, *supra* note 8.

122. *See* Jacoby, *supra* note 8, at 411.

123. *Id.*

124. David A. Skeel, Jr., *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366 (2020).

125. Illustrative cases can be found in Jacoby & Janger, *supra* note 9. *See* Janger & Levitin, *supra* note 77; Jacoby & Janger, *supra* note 2.

126. *See* Janger & Levitin, *supra* note 125.

127. *See generally* Janger & Levitin, *supra* note 7.

baseline entitlements respected. This is the opposite of bankruptcy à la carte. Bankruptcy relief is part of a quid pro quo that must be adhered to.

When the debtor seeks to address direct claims against third parties, there is no statutory guide, but there is also no statutory justification for mandatory aggregation. In the absence of insolvency, there is no reason to deny plaintiffs the chance to opt out of the settlement. Without satisfying *Ortiz*'s limited fund requirement under Rule 23 or establishing good-faith financial distress in bankruptcy, there is no justifiable reason to bind dissenters to the settlement. It is frequently said that if the third parties can't pay, they should file for bankruptcy themselves. Further, without a procedural guidepost, there is no reason to be confident of the fairness of the settlement. This is the conclusion reached by Professors Levitin, Jacoby, and Brubaker. Third-party releases are not authorized by the statute in the absence of a bankruptcy filing. That is the quid pro quo.

Putting aside the question of authorization, however, is there a nonabusive reason to consider creating a mechanism, short of bankruptcy, which might justify nonconsensual third-party releases? It turns out that the answer is yes, though perhaps not for U.S. debtors. The harms caused by mass torts are not limited to the United States, and certainly, financial distress does not recognize national boundaries. Not every nation has a bankruptcy scheme through which it is possible to open a proceeding and preserve going concern value by continuing operations. The United States and a few other countries are an anomaly in this regard. A common feature in international bankruptcies is that a case is opened in one jurisdiction, and a global solution for the entity is negotiated.[128] Some subsidiaries may not be insolvent, and/or the consequences of opening a proceeding would be devastating to the business.[129] Recently, UNCITRAL promulgated a new model law—the Model Law on Enterprise Group Insolvency (MLEG).[130] The MLEG offers a potential model for thinking about third-party participation in bankruptcy cases by separating process and recognition.[131]

The MLEG addresses the problem of international corporate group insolvency by creating something called a "planning proceeding."[132] The planning proceeding is a bankruptcy case opened by a group member.[133] Other corporate members of the group can elect to participate but need not actually file for bankruptcy.[134] They can participate in the formulation of a "group insolvency solution."[135] The problem in an international case is that

128. *See, e.g.*, U.N. COMM'N ON INT'L TRADE L., UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE: TREATMENT OF ENTERPRISE GROUPS IN INSOLVENCY, at 87, 92 U.N. Sales No. E.12.V.16 (2010), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/leg-guide-insol-part3-ebook-e.pdf [https://perma.cc/8WQR-TYYV].

129. The Southern District of New York and London are frequent venues for such group cases.

130. U.N. COMM'N ON INT'L TRADE L., *supra* note 11.

131. *See id.* at 1.

132. *See generally id.*

133. *See id.* at 9–10.

134. *See id.* at 9.

135. *See id.* at 1–2.

the relief may not be effective beyond the jurisdiction of the planning proceeding. The key to the architecture is that the group representative must seek to have the local elements of the group solution recognized in the home jurisdiction of the enterprise group member.[136] The decision about whether to recognize the group solution turns on whether the various interests are "adequately protected."[137]

Obviously, this model does not work as well in the United States, but it is possible to imagine a regime under which third parties would elect to participate in the bankruptcy without filing themselves. They could negotiate a treatment, and the settlement could be subject to approval as part of an overall solution. The question then becomes, what are the prerequisites to a nonconsensual release? There, the requirements would have to mirror the bankruptcy quid pro quo of financial distress, complete disclosure of assets, and compliance with the requirements of plan confirmation. These requirements include (1) the direct claims against third-party releasees would have to be addressed separately from the debtor's derivative claims; (2) the direct claims would have to be separately classified (and perhaps individually classified); (3) the third-party releasees would vote in their own class; (4) the third-party releasees would be entitled to best-interests protection if the class voted to accept; and (5) if the class objected, any nonconsensual release would have to meet the cramdown standard of § 1129(b) of the Bankruptcy Code.

Fans of third-party releases will suggest that these requirements are impractical, but that is exactly the point. The benefit to the releasees is that they can avoid a formal filing. But the price is that they must either get the consent of the claimant or accept the full quid pro quo for a nonconsensual release.

CONCLUSION

In sum, some of the tools for aggregation, available only in bankruptcy, are potentially useful for addressing an enterprise's mass tort liability. When used properly, they can benefit both the enterprise and the tort claimants by improving their recovery. It is crucial, however, that these tools be tethered to their justification in insolvency and subjected to appropriate process protections. These tools must be used only when necessary, and not as a tactic. Nonconsensual releases of claims against the debtor or third parties must be given only when there is a good-faith need to address financial distress, and only if the procedural protections of the plan process are observed.

136. *See id.* at 9–10.
137. *Id.* at 15.