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What Plaintiffs Can Do If J&J Succeeds In Bankruptcy Strategy

By **Edward Neiger** (September 24, 2021, 5:20 PM EDT)

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There are over 35,000 open claims in federal court linking Johnson & Johnson's talc-containing powders to ovarian cancer and mesothelioma. In light of this litigation, it's been reported that Johnson & Johnson is considering a bankruptcy maneuver known as the "Texas two-step."[1]

The strategy being explored by J&J is known as a "divisive merger" and it has been utilized where a company with massive tort liabilities splits itself into two companies and allocates the assets and liabilities however it pleases among the two successor entities. One of the newly formed units, referred to here as Newco, will hold all the liabilities and that entity will then file for Chapter 11.

Divisive mergers have been used in recent years by several companies facing large numbers of asbestos claims.

In 2017, Georgia-Pacific LLC used the Texas law to break off an affiliate that retained asbestos-related liabilities, which then sought Chapter 11 protection in the U.S. Bankruptcy Court for the Western District of North Carolina. In 2019, CertainTeed Corp. split off an asbestos affiliate, which shortly thereafter sought Chapter 11 protection in the U.S. Bankruptcy Court for the Western District of North Carolina. In early 2020, Paddock Enterprises, the entity holding the liabilities of Owens-Illinois Inc., filed for Chapter 11 protection in the U.S. Bankruptcy Court for the District of North Delaware.[2]

Plaintiffs attorneys are attempting to utilize the courts to block J&J, in advance, from implementing a divisive merger transaction.

In August, lawyers for cancer victims asked the U.S. Bankruptcy Court for the District of Delaware to issue a restraining order against J&J's proposed divisive merger as part of its oversight of the bankruptcy proceedings of Imerys Talc America, one of J&J's former talc suppliers. U.S. Bankruptcy Judge Laurie Selber Silverstein denied the request on the basis that it would be improper, as part of Imerys' bankruptcy case, to legally bar J&J from undertaking a hypothetical future restructuring.[3]

Earlier this month, plaintiffs' attorneys also filed a motion in the Superior Court of New Jersey, the state where J&J is headquartered, seeking a restraining order to prevent the transaction on the basis that it violates fraudulent conveyance laws. This request was denied on Sept. 21 with the court noting that it cannot evaluate whether a future hypothetical transaction would constitute a fraudulent transfer.[4]

Similar state court actions will likely be unsuccessful for the same reasons stated by the bankruptcy court in the Imerys case and the New Jersey court.

If J&J is successful in completing a divisive merger and filing for bankruptcy, these are some issues plaintiffs should be ready to address.

Fraudulent Transfer

Since the bankrupt "Newco" will hold the liabilities but no substantial assets, creditors will need to pursue J&J for recovery by arguing that the two-step resulted in a prima fascia fraudulent transfer. That's a pretty clear-cut argument to win, the question is who will get to make it.

Under the Bankruptcy Code, those claims belong to the debtor, and the debtor can legally settle those claims under the very low business judgement standard of Bankruptcy Rule 9019.

To wrest control of the fraudulent transfer action from the debtor, the plaintiffs will need to file what's known as an STN motion[5] to gain standing. To succeed on an STN motion, the movant will need to establish that the debtor is either not pursuing the fraudulent transfer action or cannot be trusted to settle it on an arms-length basis.

To preempt this, Newco will likely populate its board with allegedly independent directors to handle the litigation. The advent of independent directors appointed in anticipation of bankruptcy has come under scrutiny recently as some have argued this is merely a tool to divest creditors of their right to conduct their own investigation.

In fact, in the Purdue Pharma LP bankruptcy case pending in the U.S. Bankruptcy Court for the Southern District of New York, the only issue that U.S. Bankruptcy Judge Robert Drain appointed an independent examiner for was to scrutinize the independence of the board members who negotiated the resolution of fraudulent transfer claims against the Sackler family, which ultimately resulted in a $4.5 billion settlement. The examiner concluded that the board was independent.[6]

Channeling Injunction

J&J likely wants to file for bankruptcy because only in bankruptcy can it obtain a channeling injunction. A channeling injunction directs or channels tort claims, including yet to be discovered claims, to a litigation trust funded by participating parties.

This device has been utilized not only in asbestos cases — for example, Johns-Manville Corp. in the U.S. Bankruptcy Court for the Southern District of New York, W.R. Grace & Co. in the U.S. Bankruptcy Court for the District of Delaware, Owens Corning Inc. in the U.S. Bankruptcy Court for the District of North Carolina — but also in other mass tort product liability cases, such as Takata Corp. in the U.S. Bankruptcy Court for the District of Delaware.[7]

It delivers finality to the debtors and potentially others. This would allow J&J to not have to worry about future talc claims; they could move on without the burden of the talc liability ad infinitum.

Plaintiffs often disfavor channeling injunctions because they prevent them from going after the debtor for new post-bankruptcy tort cases, and, instead, are limited to pursuing their claims against the trust. In all likelihood, a channeling injunction will be established, as has been the case in the PG&E Corp. case in

the U.S. Bankruptcy Court for the Northern District of California and the Takata case as well as in asbestos bankruptcies.[8]

Bankruptcy Code Section 524(g) codified channeling injunction provisions applicable to asbestos exposure cases; however, this section has since been used a guide to fashion relief in non-asbestos mass tort cases, including those listed above.

In general terms, Bankruptcy Code Section 524(g) provides a mechanism to channel known and unknown claims to a trust while satisfying due process concerns through procedural safeguards. One key provision is the appointment of a future claims representative to protect the interests of unknown claimants who would not otherwise receive adequate notice to be bound.

Debtors facing non-asbestos mass tort liabilities, such as those in the Mallinckrodt PLC case in the U.S. Bankruptcy Court for the District of Delaware, have sought the appointment of a future claims representative to address the above due process concerns.[9]

Under the Bankruptcy Code, the bankruptcy court selects the future claims representative; however, in practice the selection responsibility is generally delegated to the debtor. This is also something plaintiffs can scrutinize.

Tort Claimants Committee

The Office of the U.S. Trustee will often appoint a separate official committee of tort claimants in cases involving substantial tort and nontort liabilities. Official tort claimant committees have been appointed in the Mallinckrodt case, in the PG&E case and in the case of the Boy Scouts of America in the U.S. Bankruptcy Court for the District of Delaware.[10] In addition, tort claimants have been appointed to official committees of unsecured creditors in numerous cases including Purdue Pharma and Weinstein Co. in the U.S. Bankruptcy Court for the District of Delaware.[11]

Official committees of tort claimants and official committees of unsecured creditors act in a fiduciary capacity for their respective contingencies and are key parties in plan negotiations in bankruptcy cases. The committee, as an estate fiduciary, will also take lead on the investigation into any potential fraudulent transfers in the event of a Newco filing. Expenses of official committee professionals, including a tort claimants committee, are paid for by the debtor's estate.

Plan Voting

This is perhaps the most powerful tool that plaintiffs will have. The one thing Newco may want more than to file for bankruptcy is to get out of bankruptcy. Under the Bankruptcy Code, debtors must solicit acceptance by each impaired class of creditors.

An impaired class is deemed to accept if the plan is approved by eligible creditors that hold at least two-thirds in amount and one-half in number of allowed claims that voted to accept or reject the plan — in asbestos cases, acceptance by 75% of voting known victim claims is required under Section 524(g).

In addition, Bankruptcy Code Section 502(c) allows the court to establish procedures for estimation of unliquidated claims with provisions for discovery, expert testimony and briefing. If plaintiffs work together in a coordinated effort, they can try to block Newco's exit from bankruptcy unless they feel

that the plan treats their claims in a fair and equitable way. This is not a surefire way to get everything you demand; the debtor still has tools at its disposal to override the votes of the plaintiffs.

The debtor may be able to structure the plan to allow a cramdown under Bankruptcy Code Section 1129(b). Under this provision, a plan may be confirmed over its rejection by an impaired class "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." This power is dependent upon acceptance of the plan by at least one class of impaired creditors — not counting insiders.

Third-Party Releases

Third-party releases are one of the most controversial aspects of a bankruptcy plan. Nonconsensual third-party releases of nondebtors from any liability related to a bankrupt company are generally only granted if the released party makes a substantial contribution to the estate through the Chapter 11 plan.

The releases regularly drew the ire of the U.S. Trustee's office but gained greater recent notoriety in the wake of the Purdue Pharma bankruptcy case and the release of the Sackler family from opioid-related liabilities in exchange for an approximately $4.5 billion financial contribution.[12] The U.S. Trustee has filed an appeal from the order confirming Purdue's Chapter 11 plan arguing that the nonconsensual third party releases contained therein are unconstitutional.

Derided as a vehicle to allow parties to take advantage of bankruptcy provisions without ever filing themselves, the contributions given in exchange for the releases can become a key source of recovery for victims, and in some bankruptcies, is the only source of recovery for creditors. In the context of the J&J case, insurance companies, J&J and its affiliates making a contribution to the victims' trust will likely demand third-party releases in return. Plaintiffs will need to scrutinize whether these entities are paying fair value for the releases they demand.

In conclusion, plaintiffs are rightfully wary of J&J's Texas two-step. If J&J proceeds with the two-step, infighting among plaintiffs with different types of injury claims would be the worst outcome strategy-wise.

If, however plaintiffs stick together and have a united front, they can collectively utilize the tools of the Bankruptcy Code, including its voting mechanisms, to exert significant leverage over J&J and the new company holding all its tort liability. This may result in a meaningful recovery for victims, and a quicker and easier payout.

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Disclosure: Ask represented tort claimants and committee members in the PG&E and The Weinstein Company bankruptcies and currently represents tort claimants in the Purdue Pharma, Mallinckrodt and Boy Scouts of America bankruptcy cases discussed above.

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[1] Cara Salvatore, "**J&J May Court Trouble With 'Texas Two-Step' Talc Gambit**," Law360.com.

[2] In re Bestwall LLC, Case No. 17-31795 (Bankr. W.D.N.C. 2017); In re DBMP LLC, Case No. 20-30080 (Bankr. W.D.N.C. 2020); Paddock Enterprises, LLC 20-10028 (Bankr. D. Del. 2020).

[3] In re Imerys Talc America Inc., Case Number 19-10289 (Bankr. D. Del. 2019).

[4] Brandi Carl v. Johnson & Johnson et al. and Diana Balderrama v. Johnson & Johnson et al., Case Numbers L-6546-14 and L-6540-14, in the Superior Court of New Jersey, County of Atlantic.

[5] Unsecured Creditors Committee of Debtor STN Enterprises, Inc. v. Noyes (In re STN Enterprises), 779 F.2d 901 (2d Cir. 1985) ("STN").

[6] In re Purdue Pharma, Case No. 19-23649 (Bankr. S.D.N.Y. 2019).

[7] In re Johns-Manville Corp., Case No. 82-11656 (Bankr. S.D.N.Y. 1982); In re W.R. Grace & Co., Case No. 01-1139 (Bankr. D. Del. 2001); In re Owens Corning, Case No. 00-3837 (Bankr. D. Del. 2000); In re TK Holdings, Case No. 17-11375 (Bankr. D. Del. 2017).

[8] In re PG&E Corp., Case No. 19-30088 (Bankr. N.D. Ca. 2019); In re TK Holdings, Case No. 17-11375 (Bankr. D. Del. 2017).

[9] In re Mallinckrodt plc, Case No. 20-12522 (Bankr. D. Del. 2020).

[10] In re Mallinckrodt plc, Case No. 20-12522 (Bankr. D. Del. 2020); In re PG&E Corp., Case No. 19-30088 (Bankr. N.D. Ca. 2019); In re Boy Scouts of Am., Case No. 20-10343 (Bankr. D. Del. 2020).

[11] In re Purdue Pharma, Case No. 19-23649 (Bankr. S.D.N.Y. 2019); In re The Weinstein Company, Case No. 18-10601 (Bankr. D. Del. 2018).

[12] In re Purdue Pharma, Case No. 19-23649 (Bankr. S.D.N.Y. 2019).