

J&J Can't Be Allowed To Dodge Civil Justice With Bankruptcy

By **Glenn Chappell, Leora Friedman and Allison Parr** (February 10, 2022, 5:26 PM EST)

Next week, a New Jersey bankruptcy judge will hear argument on whether Johnson & Johnson can use the bankruptcy system to derail tens of thousands of lawsuits and shield its assets from potentially billions upon billions of dollars in liability arising from claims that its talcum powder causes cancer.

The stakes could not be higher. J&J's corporate maneuvering threatens access to justice for thousands of cancer victims and their families, and if allowed to stand, it could lay the groundwork for other thriving companies to use the bankruptcy process to avoid their obligations under the civil justice system.

For entities that turn to the bankruptcy courts for a lifeline, the U.S. Bankruptcy Code provides extraordinary, powerful forms of relief not found in any other court. These tools serve important purposes when a financially struggling debtor seeks reorganization under Chapter 11: They give the debtor the breathing room and finality needed to embark on a fresh start, and they preserve the debtor's assets so that creditors can recover as much as possible under the circumstances.

But when the debtor is not in legitimate financial distress, those tools become weapons for injustice. Johnson & Johnson's strategy in *In re: LTL Management LLC*[1] is just such an example.

In a highly publicized ploy, J&J, one of the nation's largest and most prosperous corporations, exploited a quirk in Texas corporation law to divorce its assets from its existing and potential liabilities to plaintiffs in thousands of talc cases across the country, and it is now seeking the Bankruptcy Code's special protections to delay, hinder or limit the plaintiffs' recovery in those cases.

J&J's Texas Two-Step

In recent years, plaintiffs in thousands of personal injury suits across the country have alleged that asbestos in J&J's talc products, including its widely used baby powder, caused various illnesses, most commonly ovarian cancer and mesothelioma. To manage these cases, J&J turned to the bankruptcy process in a controversial ploy known as the Texas two-step.

The scheme is complicated, but here's a summary: J&J, a New Jersey corporation, relocated to Texas and performed a divisional merger, a unique creation of Texas corporate law, in which it split itself into two corporate entities. It put the vast majority of its assets into one of the entities and its talc-related liabilities into the other. The liability-laden entity, called LTL Management — short for Legacy Talc Litigation Management — immediately filed for Chapter 11 bankruptcy.

Through this corporate maneuvering, J&J manufactured an insolvent entity solely for the purpose of declaring bankruptcy. J&J is thriving. For 2021, the company reported 13.6% growth in sales to \$93.8 billion, including sales of \$24.8 billion in the fourth quarter alone.[2] It holds at least \$31



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billion in assets and is valued at more than \$450 billion.[3]

Although these massive revenue streams and abundant assets give it ample ability to pay judgments in favor of talc plaintiffs who prove their cases to juries, J&J created and spun off this new entity to insulate its assets from those claimants and use the unique features of bankruptcy law to limit its liability.

If J&J succeeds in pushing the case through the bankruptcy system, the extraordinary tools available to debtors and bankruptcy courts could allow this Fortune 15 company to shift the costs onto gravely ill cancer victims and their families.

Bankruptcy's Fundamental Compromise

Congress has vested the bankruptcy courts with unique, powerful tools. Among them is the automatic stay under Title 11 of the U.S. Code, Section 362, which enjoins most creditors — including litigation creditors — from filing suit to collect their debts from the bankruptcy petitioner while the bankruptcy proceeding is pending.

Bankruptcy courts can also order channeling injunctions under Title 11 of the U.S. Code, Subsections 105(a) or 524(g), which require all tort claims to be directed, or channeled, to a litigation trust funded by the bankrupt debtor so that such claims cannot be pursued against the new entity that emerges from bankruptcy or other entities affiliated with the debtor.

Finally, there is the claims-estimation process under Title 11 of the U.S. Code, Subsection 502(c), which allows the bankruptcy court to estimate the value of any contingent claims against the debtor, such as pending litigation, for the purpose of confirming a reorganization plan.

These broad equitable powers at the bankruptcy courts' disposal are supposed to facilitate the reorganization and rehabilitation of the debtor as an economically viable entity, protecting the debtor's estate from the chaos and the wasteful depletion of decentralized debt collection and litigation. Bankruptcy courts have these tools to "achieve fairness and justice in the reorganization process," according to the U.S. Bankruptcy Court for the Southern District of New York In re: Aeropostale Inc. in 2016.[4]

But these features come at a cost. Each can delay, limit or even foreclose litigation creditors' access to, and ability to recover through, the American civil justice system.

The automatic stay prevents litigation creditors from seeking relief through the judicial system for as long as it remains in effect. A channeling injunction restricts plaintiffs to claims against the assets in the trust, which can cripple their right to recovery if the trust is underfunded.

Estimation of claims can limit the amount a litigation creditor may recover because confirmation of the reorganization plan — and the consequent funding of the new entity and the creditors' potential recovery — depends necessarily on this imprecise, nonjury proceeding. If the value of pending claims is underestimated, the reorganized entity may not be sufficiently funded to cover the damages assessed by juries.

In a standard Chapter 11 reorganization case involving a debtor in bona fide financial distress, the debtor could not meet all its obligations even if its creditors turned to the courts to enforce their entitlements. In such circumstances, these powerful features of the bankruptcy system are designed to produce the most equitable result still achievable.

But there is no such trade-off when a financially secure debtor with ample assets uses corporate law loopholes to manufacture insolvency. In this situation, tools like the automatic stay, channeling injunctions, and claims estimation frustrate plaintiffs' ability to try their cases before juries and recover full compensation for the harms they suffered at the hands of the debtor.

Thus, dishonest debtors can turn the equitable purpose of bankruptcy courts on its head by using these tools to create unfairness rather than ensure a fair outcome for all involved.

The Human Interests at Stake

The consequences of abusing the bankruptcy system to halt litigation and evade liability are devastating. Jury verdicts are a lifeline for victims who use the civil justice system as intended. Talc cases have been tried across the country.

In some cases, J&J prevailed. In others, after lengthy trials, juries found that J&J's products did cause cancer, leading to severe suffering or death. For those plaintiffs who proved their cases, their verdicts provided justice in situations where time was of the essence. For those who did not, J&J avoided liability. In other words, the civil justice system worked as intended.

In *Ingham v. Johnson & Johnson*, 22 plaintiffs alleged that their frequent use of J&J's talc products caused them to develop ovarian cancer.[5] These plaintiffs underwent chemotherapy, hysterectomies and countless other surgeries that caused hair loss, sleeplessness, mouth sores, loss of appetite, seizures, nausea, neuropathy and other infections.

After a trial that lasted more than six weeks, the jury found J&J liable and awarded \$25 million in compensatory damages to each plaintiff, in addition to punitive damages. The Missouri Court of Appeals affirmed the jury's factual findings in full and entered a judgment of \$2.2 billion in damages. Tragically, five plaintiffs died during the litigation.

At only 34 years old, Christina Prudencio developed malignant mesothelioma, a terminal cancer, after daily use of talcum powder until age 16 and subsequent exposure through use of the substance on her siblings. In August 2021, after a two-month trial, a California jury awarded her \$26,572,967 in compensatory damages. This case was *Prudencio v. Johnson & Johnson* in the Alameda County Superior Court.[6]

The jury's verdict provided redress for Prudencio before it was too late. By her mid-30s, she had already "suffered through surgery, hemorrhage, and other medical issues," and, as her lawyer told the jury, her cancer will take her life "as her chemotherapy stops working." [7]

The process these plaintiffs followed is the cornerstone of the American legal system. They and J&J put their evidence before juries, and the juries decided their cases in accordance with due process of law. J&J had ample opportunity to defend the claims, and it had and has the full opportunity to seek appellate review of these judgments.

Thousands of other consumers with cancer are equally entitled to put their cases before a jury of their peers. But as these stories illustrate, time is of the essence. If J&J is permitted to use the bankruptcy process to delay justice, many of these seriously ill claimants will never get their day in court. J&J should not be permitted to manipulate the bankruptcy process and shut the courthouse doors to these victims.

A Dangerous Precedent

If allowed to stand, J&J's bankruptcy ploy will set a dangerous precedent. There is nothing stopping any financially healthy company from employing the same tactics to delay or avoid civil justice. And there is nothing special about these tactics that would limit their use to the personal injury context.

Creditors of all forms — from construction contractors to startup investors — could be stonewalled by the Texas two-step. Any debtor could use this maneuver to shield its assets from its liabilities, leaving creditors in the lurch while the debtor goes about business as usual.

Neither Congress nor the framers of our Constitution intended for the federal bankruptcy laws to be used for these purposes. At the hearing next week, the bankruptcy court will consider the talc claimants' motion to dismiss LTL Management's bankruptcy proceeding on the grounds that it was filed in bad faith to circumvent the civil justice system.

The court's decision will determine whether plaintiffs can rely on the tort litigation system or if healthy corporations like Johnson & Johnson can play shell games, denying consumers access to justice.

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[1] [In Re LTL Management LLC](#) , Case No. 21-30589 (MBK) (Bankr. D.N.J.).

[2] <https://johnsonandjohnson.gcs-web.com/news-releases/news-release-details/johnson-johnson-reports-q4-and-full-year-2021-results>.

[3] <https://www.wsj.com/market-data/quotes/jnj>.

[4] [In re: Aéropostale, Inc.](#) , 555 B.R. 369, 396-97 (Bankr. S.D.N.Y. 2016).

[5] [Ingham v. Johnson & Johnson](#) , 608 S.W.3d 663, 678 (Mo. Ct. App. 2020).

[6] [Prudencio v. Johnson & Johnson](#) , JVR No. 2109160022, 2021 WL 4268327 (Alameda County Super. Ct., Cal. Aug. 26, 2021).

[7] <https://www.law360.com/articles/1412269/j-j-s-talc-indifference-led-to-woman-s-cancer-jury-hears>.