By Jane Kim

Good Faith: What Recent Mass Tort Bankruptcy Decisions Tell Us

The past two years have witnessed a significant development of jurisprudence around the use of bankruptcy to resolve mass tort liabilities. Courts have addressed both *who* can file for bankruptcy and *what* can be accomplished in bankruptcy.

This article looks at the former issue and examines how decisions in five recent bankruptcy cases (*LTL Management LLC*,[1] *HONX Inc.*,[2] *Aearo Technologies LLC*,[3] *Bestwall LLC*[4] and *Aldrich Pump LLC*[5]) have answered that question — namely, the extent to which otherwise healthy and/or well-funded companies can use chapter 11 to manage unwieldy mass tort litigation. This includes utilizing the divisive-merger process under Texas state law, then filing a bankruptcy case for one of the new companies now saddled with legacy tort liabilities, but with funding from its nondebtor affiliate (the so-called "Texas Two-Step"). The latter — whether nonconsensual third-party releases and channeling injunctions are permissible uses of a bankruptcy court's powers — is outside of the scope of this article.

The burden and expense associated with the five aforementioned mass tort litigations cannot be overstated: Each of these bankruptcy cases was filed after the assertion of thousands, if not tens or hundreds of thousands, of lawsuits, the expenditure of many millions of dollars of legal fees and the potential for billions of dollars (or even, in Aearo's case, more than a trillion) in liability. It is no wonder, then, that in Hon. **Thomas L. Ambro**'s own words in his decision in *LTL* reversing Hon. **Michael B. Kaplan** and ordering the dismissal of LTL's first chapter 11 filing, lawyers and management are motivated to "experiment ... with novel solutions" to these issues.[6]

One of the "novel solutions" developed recently is the use of funding agreements with a healthy parent or affiliate (often an affiliate created with the debtor through a divisive merger under Texas law) to backstop the costs of a chapter 11 case of a debtor saddled with legacy mass tort liabilities. The exhibit on the next page provides information about the factual background of each case discussed herein.

The five examined cases share nearly all of the same common sets of general facts: overwhelming and incalculable mass tort liabilities; a debtor whose sole business is usually defense of those liabilities, often because it was created by a divisive merger under Texas law; and a bankruptcy process funded or backstopped by a healthy corporate parent or affiliate. Despite these similarities, however, the disposition of these cases varies widely.

In *LTL Management*, Judge Kaplan initially denied the talc claimants' motions to dismiss the chapter 11 case, but the Third Circuit panel on direct appeal, in an opinion authored by Judge Ambro, reversed and remanded for dismissal on the basis that the debtor was not in financial distress. Therefore, the debtor had not demonstrated a valid reorganizational purpose. After LTL filed its second chapter 11 case, this time with a plan-support agreement that provided a funding backstop only on confirmation of a plan with, among other things, a talc claimant trust of $8.9 billion, Judge Kaplan granted the motions to dismiss the chapter 11 case, finding that LTL lacked imminent and immediate financial distress.[7]

In *HONX*, Hon. **Marvin Isgur** denied the creditors' committee's motion to dismiss the chapter 11 case, declining, among other things, to find that the filing was in bad faith, notwithstanding Hess Corp.'s commitment to fund the debtor's § 524(g) trust.

In *Aearo Technologies*, Hon. **Jeffrey J. Graham** followed the Third Circuit's reasoning in *LTL* and granted motions to dismiss on the basis that the chapter 11 cases served no valid reorganization purpose, in part because the Aearo entities were not in financial distress.

In *Bestwall*, the Fourth Circuit (in a decision authored by Hon. Steven Agee) affirmed the lower courts' grant of a preliminary injunction of claims against nondebtor affiliates that were identical to asbestos claims against the debtor, finding that the bankruptcy court had jurisdiction over such claims.

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1 *In re LTL Mgmt. LLC*, 637 B.R. 396 (Bankr. D.N.J. 2022) ("*LTL 1.0*"); *LTL Mgmt. LLC v. Those Parties Listed on Appendix A to Complaint (In re LTL Mgmt. LLC)*, 64 F.4th 84 (3d Cir. 2023) ("*LTL Appeal*"); *In re LTL Mgmt. LLC*, 652 B.R. 433 (Bankr. D.N.J. 2023) ("*LTL 2.0*").

2 *In re HONX Inc.*, 2022 Bankr. LEXIS 3651 (Bankr. S.D. Tex. Dec. 28, 2022).

3 *In re Aearo Techs. LLC*, 2023 Bankr. LEXIS 1519 (Bankr. S.D. Ind. June 9, 2023). *In re HONX Inc.*, Case No. 22-90035, 2022 Bankr. LEXIS 3651, 2022 WL 17984313 (Bankr. S.D. Tex. Dec. 28, 2022).

4 *Bestwall LLC v. Off. Comm. of Asbestos Claimants (In re Bestwall LLC)*, 71 F.4th 168 (4th Cir. 2023). *In re Aearo Techs. LLC*, Case No. 22-02890-JJG-11, 2023 Bankr. LEXIS 1519, 2023 WL 3938436 (Bankr. S.D. Ind. June 9, 2023).

5 *In re Aldrich Pump LLC*, Case No. 20-30608, 2023 Bankr. LEXIS 3043, 2023 WL 9016506 (Bankr. W.D.N.C. Dec. 28, 2023).

6 *LTL Appeal*, 64 F.4th at 111.

7 *LTL 2.0*, 652 B.R. at 456.

In *Aldrich Pump*, Hon. J. Craig Whitley denied motions to dismiss filed by the asbestos claimants, finding that financial distress was not a requirement for filing a chapter 11 case, and that the cases were not bad-faith filings under Fourth Circuit law.

The wide range of outcomes, based on substantially similar fact patterns, raises a number of questions.

Is Financial Distress a Prerequisite for a Bankruptcy Filing?

In the Third Circuit, the answer is definitively "yes, financial distress is required for a bankruptcy filing," as was reestablished in the *LTL* decision.[8] The answer is different in other circuits.

Section 1112(b) requires conversion of a chapter 11 case or dismissal, "whichever is in the best interests of creditors and the estate, for cause."[9] To refute "cause" for dismissal, a showing of "good faith" is required in every circuit.[10] However, different jurisdictions have markedly different tests and standards for what constitutes "good faith."

The Third Circuit's test for what constitutes "good faith" is an objective one for which there are two "particularly relevant" inquiries: whether the filing "serves a valid bankruptcy purpose," and whether the case was filed "merely to obtain a tactical litigation advantage."[11] A "valid bankruptcy purpose 'assumes a debtor in financial distress'" such that under Third Circuit law, "'good faith necessarily requires some degree of financial distress on the part of a debtor.'"[12]

In *Aearo*, Judge Graham, having failed to find clear law in the Seventh Circuit defining "good faith," found the logic of the Third Circuit's *LTL* decision "persuasive," although he framed the test as requiring that a debtor demonstrate the "need" (and not necessarily financial distress) for bankruptcy relief.[13] By contrast, the Fourth Circuit uses "a more comprehensive standard" under which a movant seeking dismissal "must show *both* '*subjective* bad faith' *and* the 'objective futility of any possible reorganization.'"[14] In other words, absent actual "motivation ... to abuse the reorganization process and to cause hardship or to delay creditors," there is no bad faith.[15]

Other circuits sit between these two extremes. For example, the Fifth Circuit looks at the "totality of the circumstances," under which courts evaluate "the debtor's financial condition, motives, and the local financial realities."[16] The Ninth and Eleventh Circuits' determination of a debtor's good faith

8 In *LTL Appeal*, Judge Ambro cited two earlier Third Circuit decisions for the proposition that Third Circuit "precedents show a debtor who does not suffer from financial distress cannot demonstrate its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith." *LTL Appeal*, 64 F.4th at 101 (citing *In re SGL Carbon*, 200 F.3d 154 (3d Cir. 1999); *NMSBPCSLDHB LP v. Integrated Telecom Express Inc. (In re Integrated Telecom Express Inc.)*, 384 F.3d 108 (3d Cir. 2004)).

9 11 U.S.C. § 1112(b).

10 *See, e.g., LTL Appeal*, 64 F.4th at 100; *Aldrich Pump*, 2023 Bankr. LEXIS 3043, at *84, 2023 WL 8016506 at *30 (collecting cases).

11 *Id.* at 100-01.

12 *Id.* at 101 (citing *NMSBPCSLDHB LP v. Integrated Telecom Express Inc. (In re Integrated Telecom Inc.)*, 384 F.3d 108, 121, 128 (3d Cir. 1999)).

13 *Aearo Techs.*, 2023 Bankr. LEXIS 1519 at *48, 2023 WL 3938436 at *17 (3d Cir. 2004).

14 *Bestwall*, 71 F. 4th at 182 (citing *Carolin Corp. v. Miller*, 886 F.2d 693, 694 (4th Cir. 1989)) (emphasis added).

15 *Aldrich Pump*, 2023 Bankr. LEXIS at *66, 2023 WL 9016506 at *23.

16 *HONX Inc.*, 2022 Bankr. LEXIS 3651 at *4, 2022 WL 17984313 at *1.

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Exhibit

Case (Bankruptcy Case Venue)	Type of Mass Tort Liability	Was the Debtor the Product of a Texas Two-Step?	Did the Debtor Have Any Other Business Besides Defending the Tort Liability?	Did the Debtor Have Funding from a Parent or Affiliate?
LTL Management LLC (D.N.J.)	Mesothelioma and other illnesses allegedly caused by Johnson's Baby Powder.	Yes (a divisive merger created the debtor, LTL Management LLC, and new nondebtor affiliate, Johnson & Johnson Consumer Inc.).	No.	Yes (uncapped in LTL 1.0; limited in LTL 2.0 to confirmation of plan with $8.9 billion trust).
HONX Inc. (S.D. Tex.)	Asbestos-related liability stemming from HONX's own earlier operation of an oil refinery in St. Croix.	No.	No.	Yes ($10 million initial commitment from parent Hess Corp., but representations that Hess would continue to support chapter 11 beyond initial commitment).
Aearo Technologies LLC (S.D. Ind.)	Hearing loss and hearing defects arising from the use of military earplugs manufactured and sold by Aearo.	No (3M's acquisition of Aearo occurred before the onslaught of tort litigation).	Yes.	Yes ($1.24 billion).
Bestwall LLC (W.D.N.C.)	Asbestos-related liability arising out of the sale of products by Bestwall Gypsum Co., which later was acquired by Georgia-Pacific LLC.	Yes (the divisive merger of Georgia-Pacific LLC created the debtor, Bestwall LLC, and the new nondebtor, Georgia-Pacific LLC).	No.	Yes (uncapped, as necessary).
Aldrich Pump LLC (W.D.N.C.)	Asbestos-related liability of Trane Technologies Co. LLC and Trane U.S. Inc.	Yes (the divisive mergers creating Aldrich Pump LLC and Murray Boiler LLC).	No.	Yes (essentially uncapped).

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"depends on an amalgam of factors and not upon a specific fact"; a court "may consider any factors which evidence 'an intent to abuse the judicial process and the purposes of the reorganization provisions.'"[17] As such, unsurprisingly, the answer to what kind of debtor can file for chapter 11 protection and under what circumstances is, quite clearly, "It depends on the jurisdiction."[18]

Is a Debtor Formed Using the Texas Two-Step Immediately Suspect?

In his *LTL* opinion for the Third Circuit, Judge Ambro was careful not to cast aspersions on the use of the Texas divisive-merger statute to create a chapter 11-ready debtor, declining to agree that "any divisional merger to excise the liability and stigma of a product gone bad contradicts the principles and purposes of the Bankruptcy Code."[19] Indeed, his statement that "[c]reative crafting in the law can at times accrue to the benefit of all or nearly all stakeholders"[20] leaves open the door to continued tinkering.

However, what some call "creative crafting" other judges call "manipulation of the Bankruptcy Code" and "contrived," "manufactured" and "fabricated" jurisdiction.[21] For example, Hon. Robert King, in his dissent in *Bestwall*, evidences his displeasure in the idea that "the Article I bankruptcy courts" — courts that he repeatedly notes are courts of limited jurisdiction — could "shelter" solvent corporations from "sweeping tort litigation."[22] It is understandable that an appellate court may rankle at the idea that an Article I court could exercise expansive jurisdiction over lawsuits pending in state courts and federal (Article III) courts, or that mass tort defendants could avail themselves of bankruptcy courts to maneuver out of the trial courts' jurisdiction and avoid litigating within the tort system. This leads to the next question.

Are There Better Means of Resolving Mass Tort Liabilities?

This question was the focal point of Judge Kaplan's full-throated defense of the bankruptcy process in resolving mass tort liabilities:

> Every one of the Court's 370-plus colleagues on the bankruptcy bench can point to successful case outcomes where large and small businesses are reorganized, productive business relationships are maintained, jobs preserved and, most importantly, meaningful returns distributed to creditors — all in situations where outside of the bankruptcy system there would be fewer if any identifiable benefits, and the parties left to expensive and time-consuming litigation. This holds especially true for mass tort situations, including asbestos bankruptcies, in which § 524(g) trusts and comparable non-asbestos trust vehicles have been established to ensure meaningful, timely recoveries for present and future suffering parties and their families.[23]

In *LTL 1.0*, Judge Kaplan looked at the tort system, including class actions and the multi-district litigation (MDL), and found that the system is "ill-equipped to provide for future claimants" and "produces an uneven, slow-paced race to the courthouse, with winners and losers."[24] Thus, he championed "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 ... in a single forum with an aim of reaching a viable and fair settlement."[25]

Notably, even after the Third Circuit reversed his *LTL 1.0* decision, in his subsequent decision dismissing *LTL 2.0* for lack of good faith, Judge Kaplan continued to express "apprehensions" about the ability of the tort system to resolve globally the debtor's talc liability, and lamented that "the Court remains unconvinced that the procedural mechanisms and notice programs offered in the tort system can protect claimants' rights in the same manner as the available tools in the bankruptcy system."[26] Nevertheless, constrained by the Third Circuit's ruling, Judge Kaplan found that cause existed to dismiss *LTL 2.0*.

By contrast, Judge Graham in *Aearo* expressed no such concerns, nor the same faith in the bankruptcy process held by Judge Kaplan. Instead, Judge Graham observed that, notwithstanding the fact that the 255,500 actions pending in the MDL made it the largest MDL in history "by an order of magnitude" such that even a 99 percent opt-in rate would leave enough unresolved actions to constitute, on their own, the fifteenth-largest MDL currently pending, "the Court received no evidence [of] whether opt-outs could be handled better or more efficiently inside or outside of a Chapter 11 bankruptcy."[27]

That said, Judge Kaplan's warning in *LTL 2.0* is significant: "No party or expert has identified even a single example of a global settlement outside of bankruptcy that has been achieved in circumstances like this case — where both latent injuries and unknown future claimants exist."[28] In the absence of the bankruptcy path to resolution, it remains unclear whether an effective, equitable and global process exists to address mass tort liabilities.

17 *Marshall v. Marshall (In re Marshall)*, 721 F.3d 1032, 1048 (9th Cir. 2013) (citing *Phoenix Piccadilly Ltd. v. Life Ins. Co. of Va. (In re Phoenix Piccadilly Ltd.)*, 849 F.2d 1393, 1394 (11th Cir. 1988)) (other internal citations omitted).
18 In his opinion for the Third Circuit in *LTL*, Judge Ambro somewhat cynically observed, "[p]erhaps not by coincidence then, debtors formed by divisional mergers and bearing substantial asbestos liability seem to prefer filing in the Fourth Circuit." *LTL Appeal*, 64 F.4th 98, n.8 (internal citations omitted).
19 *LTL Appeal*, 64 F.4th at 111.
20 *Id.*
21 *Bestwall*, 71 F.4th at 186, 189, 193 (King, J., dissent).
22 *Id.* at 186.
23 *LTL 1.0*, 637 B.R. at 410.
24 *Id.* at 412, 414.
25 *Id.* at 414.
26 *LTL 2.0*, 652 B.R at 449, 451.
27 *Aearo*, 2023 Bankr. LEXIS 1519, at **10, 55, 10, 55, 2023 WL 3938436 at **3, 19.
28 *LTL 2.0*, 652 B.R. at 450.

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What Is Next?

It is worth noting that three of the cases discussed in this article are pending appeal. The Third Circuit accepted a direct appeal of Judge Kaplan's dismissal order in *LTL 2.0*. The *Bestwall* official committee of asbestos claimants filed a petition for *certiorari* with the U.S. Supreme Court for review of the Fourth Circuit's decision. *Aldrich Pump* is on appeal to the U.S. District Court for the Western District of North Carolina. With these pending appeals, as well as the as-yet-unissued Supreme Court decision in *Purdue Pharma*, the landscape of mass tort bankruptcy jurisprudence surely will develop further. abi