# The Bankruptcy Balancing Act in Mass Tort Cases


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**Can The Bankruptcy Courts Continue to Effectively Navigate the Current Flood of Mass Tort Claims in Mass Tort Bankruptcy Cases?**
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**The Current Bankruptcy Mass Tort Landscape**
As of October 14, 2021, the day that LTL Management, LLC, the spinoff of Johnson & Johnson Consumer, Inc. ("Old JJCI"), filed for bankruptcy, there were some 38,000 talc claims pending against Old JJCI. While many additional talc claims had previously been dismissed or failed at trial, a few claims resulted in massive jury verdicts, e.g., one for $2.85 billion.[1] Following these significant verdicts, talc litigations were being filed at the rate of 1 per hour, 365 days per year. As a result, in addition to its indemnity obligations, Old JJCI was paying $10 million to $20 million per month in professional fees to defend the suits. All in, an amount equal to 33% of the company's total sales were being spent on the talc cases each year. Old JJCI's total exposure has been estimated in the hundreds of billions of dollars.

Similarly, as of July 26, 2022, the day it filed for bankruptcy, Aearo Technologies, LLC, a company with 330 employees and approximately $100 million in annual sales, was facing a multi-district litigation ("MDL") on account of allegedly faulty combat earplugs comprised of 290,000 claims and an estimated liability of $100 billion[2]—an amount equal to 1,000 years of Aearo's annual sales.

Bankruptcy courts have dealt with mass tort claims before, in cases like Johns Manville,[3] A.H. Robbins,[4] and W.R. Grace[5] dating back to 1982 and earlier. But in the age of social media, with attorney advertising moving beyond radio ads and television commercials, to wide-reaching Facebook, Twitter and other media outlets, claims can multiply at an astonishing rate. Take for instance the In re Boy Scouts of America bankruptcy proceeding, which, prior to filing for bankruptcy protection, had suffered "hundreds" of sexual abuse litigation claims at a cost for indemnification and loss adjustment expenses of approximately $150 million during the prepetition period from 2017 through 2019.[6] Following the bankruptcy filing, and the attendant publicity and social media blitz that ensued, some 82,209 unique and timely claims were filed asserting abuse,[7] requiring a settlement fund for the post-confirmation trust running into the billions of dollars.

The Purdue Pharma L.P.[9] chapter 11 plan of reorganization, providing billions of dollars for opioid claims, and supported by 95% (or 120,000) of the voting plaintiffs in the case, is on appeal to the Second Circuit where the third-party releases granted to the Sackler family members (owners of Purdue Pharma) in return for a voluntary payment of $6 billion are being challenged by a very small number of appellants.[10] The Boy Scouts of

1 Ingham v. Johnson & Johnson, 608 S.W.2d 663, 724-725 (Mo. Cir. Ct. 2018).

2 Testimony of Dr. J.B. Heaton. See August 26,2022 Bankruptcy Court Order at Docket #143, Case No. 22-50059, at p. 33.

3 MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89 (2d Cir. 1988).

4 Menard–Sanford v. Mabey (In re A.H. Robins Co., Inc.), 880 F.2d 694 (4th Cir. 1989).

5 In re W.R. Grace & Co., 729 F.3d 332 (3d Cir. 2013).

6 Decision of Judge Laurie Selber Silverstein dated July 29, 2022, Docket # 10,343, Case No. 20-10343, at p. 20.

7 Id. at 23.

8 See, e.g., Camp Lejeune Victims, available at https://www.camplejeunevictims.com/v3/1step/lac01/ (last visited September 25, 2022).

9 The Purdue cases are jointly administered under Case No. 19-23649 before the United States Bankruptcy Court for the Southern District of New York.

10 The case is In re: Purdue Pharma LP et al., Case No. 22-110, in the U.S. Court of

America plan, which provides for the funding of a $2.46 billion trust for abuse claims, was appealed by a number of insurers.[11] The LTL talc cases and the Aearo cases face substantial uphill battles with swarms of claims coming in every day.

### The Policy of the Bankruptcy Code

The American justice system is premised upon due process and the ideal that every injured or aggrieved person will have both the right and the opportunity to "have her day in court," in order to prove her claim and to obtain recompense. However, there is also the "race to the courthouse" concept, embedded in American jurisprudence, such that the first plaintiff that obtains a judgment typically will have rights under state law to impose liens on the defendant's assets in order to collect on her claim, before those who may be awaiting their day in court in the same forum or in other jurisdictions. Accordingly, in mass tort cases, plaintiffs that file first may exhaust liability insurance recoveries and other assets of the defendant in advance of injuries to, let alone claims of, potential future plaintiffs.

The Bankruptcy Code[12] was designed to provide a "breathing spell" from creditor actions during the pendency of the bankruptcy case, and ultimately, give an honest debtor a "fresh start." More subtle policy underpinnings also guide the chapter 11 process: (i) that going concern value is better than liquidation value, i.e., that assets provide more value to all stakeholders when they continue to operate in the stream of commerce; and (ii) the economy, specifically the players in our economy like employees (salaries), retirees (pension benefits), the government (taxes) and other businesses and creditors (contractual and business arrangements), are all better off in a restructuring where the business continues, rather than in a liquidation where the business ceases to operate. Indeed, section 1129(a)(7) of the Bankruptcy Code, which articulates the "best interest of creditors" test, requires analysis of this test in every chapter 11 case. Specifically, to confirm a chapter 11 plan and exit bankruptcy, a corporate debtor must prove that creditors and other stakeholders, including plaintiffs, will obtain "more than they would in a … liquidation" of the company. When companies liquidate, employees lose their jobs, retirees may lose their pensions, the government misses out on tax revenue, and vendors lose their customer, resulting in "game over" losses for layers of economically inter-related stakeholders. Most importantly, in the context of this article, in a liquidation where insurance proceeds are exhausted—only the first plaintiffs that obtained judgments such that they were situated in the front of the line will get paid on account of their personal injury claims, while those still awaiting trial and those whose injuries have not yet manifested will find themselves without an effective remedy.

### Bankruptcy Code Provisions Benefiting Tort Victims and Their Attorneys

There are a number of bankruptcy provisions that benefit creditors. Sections 501 and 502 of the Bankruptcy Code, coupled with Rule 3003 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), provide that a proof of claim, when timely filed, "is deemed allowed" unless a party in interest objects. In other words, the filing of a proof of claim is prima facie evidence of its validity.[13] By contrast, in state or federal court, a plaintiff doesn't "win" simply by filing a complaint. Rather, when a defendant defaults in a state or federal court action, that is simply step one of the process. Next, the plaintiff will typically be required to enter default on the docket, seek the entry of judgment by default, present its proofs at a hearing on damages and then, once judgment is entered and docketed, seek to collect on its claim. None of these steps is required in a bankruptcy case, where filing of the claim itself checks all the boxes to perfect the claim and sets the claimant up for collection. If no objection is filed, the claim is allowed as stated. Further, the proof of claim is generally a simple one-to-two-page form requiring only the claimant's name, address, alleged amount of the claim, and a signature.

Section 1103 of the Bankruptcy Code provides that

Appeals for the Second Circuit.

11 Dietrich Knauth, Boy Scouts' $2.46 billion bankruptcy settlement draws appeals from insurers, abuse claimants, Reuters (September 22, 2022), available at https://www.reuters.com/legal/litigation/boy-scouts-246-billion-bankruptcy-settlement-draws-appeals-insurers-abuse-2022-09-22/(last visited September 25, 2022).

12 11 U.S.C. 101 et seq.

13 "A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001.

"the United States Trustee shall appoint a Committee of Creditors" (the "Committee"). Appointment of a Committee is not optional in a chapter 11 case, and the United States Trustee ("UST") takes this obligation very seriously. In a mass tort bankruptcy case, the UST may appoint a "Tort Claimants Committee,"[14] or may mix the tort victims with trade creditors by appointing one joint committee of creditors.[15] Committees are afforded broad powers under the Bankruptcy Code, including the ability to "investigate the acts, conduct, assets, liabilities and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan."[16] Bankruptcy proceedings are broadly transparent, with the bankruptcy courts requiring cooperation in discovery, and the Bankruptcy Rules—particularly Rule 2004—allowing "fishing expeditions" by a Committee or others into a debtor's financial affairs, something that would never be countenanced during the pendency of a state or federal court litigation.[17]

All of these rights and powers of a Committee might be of less concern to corporate debtors but for two additional sections of the Bankruptcy Code. First, the Bankruptcy Code permits a Committee to hire attorneys, financial advisors, accountants, investment bankers, appraisers, and other professionals. Significantly, the fees incurred by these professionals are paid not by the Committee members or by the underlying plaintiffs, but rather by the bankruptcy estate. Second, if a debtor's assets are under the control of the bankruptcy court, a requirement for plan confirmation and exiting bankruptcy is that all post-petition professional fees must be paid in full.[18]

By comparison, in a typical litigation, a plaintiff's attorney must, inter alia, (i) prepare and file a complaint, (ii) prosecute the action through to judgment, potentially involving years of discovery and motion practice, and (iii) after obtaining a judgment, seek to collect on that judgment, an effort that in many cases is more difficult than obtaining the judgment itself. Instead, as the Bankruptcy Code sections described above reveal, a plaintiff's attorney prosecuting a mass tort claim in a bankruptcy case can (i) assist her client in filling out a two-page proof of claim form, or not, as these forms are simple enough for the client to fill out without an attorney's help, (ii) file the form without appearing on the docket in the case (claims are maintained on a separate "creditor registry" or matrix), (iii) have a client's form constitute prima facie evidence of the claim, which will result in "allowance" of the claim unless it is objected to, (iv) review the corporate debtor's financial dealings since they will be an "open book" pursuant to the transparency present in a chapter 11 case, (v) use as a collection tool the Tort Claimants Committee or Committee and their financial and legal professionals which will learn everything about the debtor's finances and to fight for the highest possible distribution , and (vi) avoid the costs of collection, because the Committee's professionals will be paid for by the corporate debtor, and so the more the debtor fights, the more it pays.

Sections 544 and 548 of the Bankruptcy Code convey to the debtor's estate creditor actions to recover on account of fraudulent transfers. While technically, by virtue of these provisions, fraudulent conveyance actions are no longer owned by individual creditors, but instead belong to the estate, in the typical case, debtors are unwilling or unable to bring fraudulent conveyance actions against their parents, officers and directors or affiliates. As a result, the Committee will petition the court for derivative standing to do so on the estate's behalf.[19] Such standing is often granted.

In both the Aearo and LTL cases, the non-debtor affiliates and parents of both companies entered into billion-dollar funding agreements with the prepetition debtors to reimburse them for any

14 See In re the Roman Catholic Diocese of Camden, Case No. 20-21257 before the United States Bankruptcy Court for the District of New Jersey, Docket Nos. 111, 29, where the United States Trustee appointed two committees: one consisting strictly of tort claimants and the other consisting of trade creditors, respectively.

15 Purdue Pharma, Case No. 19-23649 before the United States Bankruptcy Court for the Southern District of New York, and The Weinstein Companies, Case No. 18-10601 before the United States Bankruptcy Court for the District of Delaware, are two recent cases where the United States Trustee appointed mixed committees containing both business/trade creditors and tort claimants.

16 11 U.S.C. §1103(c)(2).

17 See In re SunEdison, Inc., 572 B.R. 482, 490 (Bankr. S.D.N.Y. 2017)(scope of Rule 2004 is very broad, sometimes referred to as a "fishing expedition").

18 11 U.S.C. §§507(a)(2) and 1129(a)(9)(A).

19 See Official Comm. of Unsecured Creditors Corp. v. Chinery, 330 F.3d 548, 568, 580 (3d Cir. 2003)("Cybergenics") (holding that bankruptcy courts can authorize creditors' committees to pursue avoidance actions). Courts following Cybergenics have determined that the Committee or individual creditors can pursue suit if: (1) the creditor alleges a colorable claim that would benefit the estate; (2) the creditor makes demand on the debtor in possession to file the action; (3) the demand is refused; and (4) the refusal is unjustified in light of the statutory obligation and fiduciary duties of the debtor-in-possession.

mass tort liabilities the debtors could not satisfy themselves. Why did they do so? Because had they not, they would likely be easy targets for fraudulent conveyance actions seeking to bring affiliate and parent assets into the bankruptcy. By doing this voluntarily, however, the issue is not resolved; rather, a fraudulent conveyance action may still be brought, but the conversation changes to whether or not the parent or affiliate's funding commitment is fair consideration for any value extracted by the affiliates and/or parents from the corporate debtors.[20]

**Bankruptcy Code Provisions Benefitting the Corporate Debtor**

The automatic stay embodied in section 362 of the Bankruptcy Code is the codification of the "breathing spell" doctrine described above. It takes effect automatically and contemporaneously with the filing of the bankruptcy petition and enjoins any lawsuits or actions against the debtor from proceeding. Its reach includes mass tort plaintiffs' claims. For example, Old JJCL faced 38,000 tort claims and was spending
$10 million to $20 million per month on defense costs; Aearo faced 290,000 MDL claims. The automatic stay provides the necessary breathing spell for the debtors facing these unprecedented numbers of claims to pause to consider and develop a plan for payment of the plaintiffs' claims, negotiate a plan with the representatives of the various stakeholders, most importantly in a mass tort case, with the Committee, and to chart a course to continue their operations.

Similarly, section 105 of the Bankruptcy Code allows, in certain circumstances, the court to enjoin actions against third parties of the debtors, such as affiliates. For example, in the Roman Catholic Diocese cases, of which there have been some 30 filed nationwide, separately incorporated parishes that were not in bankruptcy received the benefit of an injunction under section 105, which prevented plaintiffs from proceeding against the parishes, even though those parishes were not suffering the burdens of bankruptcy. In addition, in In re Boy Scouts of America, some 500 separately incorporated local boy scout councils all over the country, as well as "Chartered Organizations" that had allowed the Boy Scouts to use their facilities for meetings, received injunctions protecting them from lawsuits during the pendency of the Boy Scout bankruptcy case. This injunction granted pursuant to section 105 is sometimes referred to as "extending the automatic stay" to protect these non-debtor parties.[21] In the LTL case, Judge Kaplan entered a section 105 injunction protecting affiliates of LTL, including its indirect parent Johnson & Johnson, thereby enjoining plaintiffs from bringing or continuing any pending talc lawsuits against these non-debtor affiliates. By contrast, Judge Graham, in the Aearo case, recently denied a section 105 injunction that would have protected Aearo's parent, 3M, from the onslaught of earplug cases it is currently defending. Both decisions are currently on appeal to the Third Circuit and the Seventh Circuit, respectively.

Section 524(g) of the Bankruptcy Code is a bankruptcy "superpower" available only in asbestos chapter 11 proceedings, although that has not stopped the debtor's bar from modeling bankruptcy plans along the same lines and successfully confirming bankruptcy plans using a structure akin to the relief section 524(g) provides. Section 524(g) utilizes a procedural device referred to as a "channeling" injunction wherein a trust is created under the bankruptcy plan, and all claims derivatively related to any asbestos injury caused by the debtor are "channeled" into the trust. This includes claims against affiliates, parents, predecessors, successors, and insurers that contribute to the trust via settlement with the debtor or otherwise.[22] Notably, section 524(g) requires an affirmative vote in support of the plan by 75% of personal injury claimants, a significantly higher bar than the "more than one-half in number" requirement for an "ordinary" plan confirmation that does not include a channeling injunction.[23] It also requires that the trust created for this purpose be funded with, among other things, a majority of the voting shares of the debtor or its parent.[24] In practice, however, channeling injunctions modeled on section 524(g) have become routine in mass

20 In the Caesar's Entertainment bankruptcy, Case No. 15-01145 before the United States Bankruptcy Court for the Northern District of Illinois, affiliates that had siphoned off Debtor's assets prepetition had agreed prior to the bankruptcy to repay $2 billion to the bankrupt debtors for the purpose of addressing creditor claims. But after an Examiner's report commissioned as a precursor to a Committee fraudulent conveyance action, resulting in, among other things, a ruling that the billionaire owners had to turn over their personal financial statements to the Committee, the affiliates' settlement offer increased from $2 billion to more than $5 billion.

21 In re Aearo Technologies, LLC, et al., Case No. 22-50059 (August 26,2022 Bankruptcy Court Order at Docket #143, at pp. 21-22).

22 11 U.S.C. § 524(g)(1)(B), 524(g)(3)(A), 524(g)(4)(A).

23 Compare 11 U.S.C. §524(g)(B)(ii)(IV) with 11 U.S.C. §1125(c).

24 11 U.S.C. § 524(g)(1)(B)(i)(III).

tort and other bankruptcy cases, and for the most part, are supported by Committees and plaintiffs, often without any stock ownership interest being contributed to the trust, as would be required by the plain terms of section 524(g).

Section 502(c) of the Bankruptcy Code provides for estimation of claims, i.e., the ability to fix claims in a truncated procedure, without a full trial.[25] While there are constitutional problems with this procedure in a personal injury case,[26] all parties recognize the risks of litigation on the issue, and therefore Tort Claimants Committees typically negotiate, and personal injury claimants overwhelmingly vote, in support of bankruptcy plans that create Trust Distribution Procedures ("TDPs"). These TDPs provide a matrix to be utilized by a post-confirmation "Plan Trustee" or "Administrator," which is used to value claims quickly and easily. The Boy Scout plan even included a "no look" settlement, where a plaintiff could accept $3,000 in settlement and avoid any scrutiny of his claim, other than inquiry into whether the claim was timely filed and signed. Thousands of Boy Scout claimants availed themselves of this option.

In addition to these statutory provisions, which serve to strike a balance between the corporate debtor and the mass tort victims, there is the bankruptcy judge, who often times, via his or her decisions throughout the case or otherwise, either gently or firmly moves the parties towards a resolution. And in furtherance of the goal of a mediated settlement, bankruptcy judges in mass tort cases in recent years have appointed mediators, who are often retired bankruptcy judges, to mediate discussions between the Tort Claimants Committees, the debtors, and the insurers. These efforts have yielded success, with few, if any, mass tort bankruptcy proceedings ending in the liquidation of the debtor.

## Conclusion

The easy aggregation and multiplication of mass tort claims in today's social media world, coupled with the simplicity of perfecting a claim in bankruptcy and collecting on tort claims via "free" discovery and collection tools that bankruptcy offers creditors provides a huge time and cost savings to plaintiffs and the plaintiffs' bar. Corporate debtors, in turn, have found themselves addressing exponentially larger claims than they had anticipated prior to the bankruptcy filing, which strains their resources beyond the point of insolvency and easily exhausts insurance coverages. And while the bankruptcy system has clearly bent under the weight of the onslaught, it has not broken. The ultimate goal of any bankruptcy reorganization—maintaining value for all stakeholders—continues to be paramount. Bankruptcy's financial transparency, automatic stay, section 105 injunctions, claims estimation powers, post-confirmation trusts, and channeling injunctions continue to be valuable tools that debtors and courts can use to strike a balance between the goals of maximizing distribution to all stakeholders and the successful reorganization of the corporate debtor.

25 In re North American Health Care, Inc., 544 B.R. 684, 688 (Bankr. C.D. Cal. 2016) (bankruptcy court could estimate personal injury/wrongful death tort claims in the aggregate and not individually, for purposes of voting and plan confirmation).

26 See, e.g., Stern v. Marshall, 131 S. Ct. 2594 (2011) (Article I Bankruptcy Courts cannot adjudicate a claim where there is a Constitutional right for that claim to be adjudicated before an Article III Court.