Bankruptcy Law Letter

AUGUST 2022 | VOLUME 42 | ISSUE 8

ASSESSING THE LEGITIMACY OF THE "TEXAS TWO-STEP" MASS-TORT BANKRUPTCY

By Ralph Brubaker

INTRODUCTION

I always tell my students that corporate restructuring work is perhaps the most complex and sophisticated legal practice to which they could aspire and that there are no bounds to the creative brilliance and ingenuity of corporate reorganization professionals. The new Exhibit A for my case: the "Texas Two-Step" mass-tort bankruptcy,[1] which proceeds essentially as follows:

Step 1. Mass-tort Defendant uses a state divisional merger statute (Texas's[2] has been the eponymous statute of choice) to divide itself into two new companies, GoodCo and BadCo. BadCo takes on all of Defendant's mass-tort liability, but also receives the benefit of a funding agreement whereby GoodCo agrees to pay all of the mass-tort obligations allocated to BadCo. GoodCo receives substantially all of Defendant's operating business and other assets and liabilities *except* the mass-tort liability, which is replaced by GoodCo's obligations under the funding agreement with BadCo.

Step 2. BadCo files Chapter 11, but GoodCo continues Defendants' business operations without filing bankruptcy. Thus, the mass-tort liability is resolved through the Chapter 11 process without having to put the business in bankruptcy.

There are currently four such Texas Two-Step bankruptcies that have been filed in recent years, all of which are still *sub judice*, but the one that has attracted the most attention and critical scrutiny is the *LTL Management* case filed in order to resolve the talc liability of Johnson & Johnson (J&J). The official tort claimant's committee filed a motion to dismiss the *LTL* case as a bad-faith filing, but the bankruptcy court denied that motion in late February.[3] In a thorough and thoughtful opinion, the court studiously defended the legitimacy of the Texas Two-Step bankruptcy, at least on the facts of the *LTL* case, but with some reasoning that also speaks to even larger systemic issues of how best (and in what forum) to resolve mass-tort obligations generally. That decision (currently on appeal

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in the Third Circuit) thus provides an opportune occasion to take stock of this innovative new bankruptcy strategy at the intersection of complex litigation and corporate reorganizations.

THE TEXAS TWO-STEP BANKRUPTCIES (TO DATE)

1. BESTWALL (FROM GEORGIA-PACIFIC), DBMP (FROM CERTAINTEED), ALDRICH PUMP AND MURRAY BOILER (FROM TRANE)

All of the Texas Two-Step bankruptcies to date are asbestos-liability cases involving very large, well-known companies. The first came from Georgia-Pacific, one of the world's leading makers of tissue, pulp, packaging, and building products, whose asbestos liabilities are attributable to its 1965 acquisition of Bestwall Gypsum Co., and thereafter, Georgia-Pacific continued to manufacture and sell the Bestwall asbestos-containing products, principally joint compound. In a 2017 divisional merger, Georgia-Pacific spun off its asbestos liability into a BadCo named BestWall LLC, which filed Chapter 11 in the Western District of North Carolina about one month later. The official asbestos claimants' committee filed a motion to dismiss the case as a bad faith filing, but (unsurprisingly, given Fourth Circuit law on the issue, discussed below) that motion was denied.[4] And all of the subsequent Texas Two-Step bankruptcies were then also filed in the Western District of North Carolina.

The second Texas Two-Step case involves CertainTeed, a building products manufacturer whose asbestos liability is attributable to various piping and roofing products. Its October 2019 divisional merger produced a new BadCo named DBMP LLC, which filed Chapter 11 in the Western District of North Carolina three months later in January 2020.[5] A few months later, in May 2020, the two parents in the Trane corporate family, manufacturers of HVAC systems, shunted their respective asbestos liabilities (via divisional mergers) into two new BadCos named Aldrich Pump LLC and Murray Boiler LLC, which filed their Chapter 11 petitions in the Western District of North Carolina seven weeks later, in June 2020.[6]

2. J&J BEGETS LTL MANAGEMENT

The most recent and visible Texas Two-Step bankruptcy, of the BadCo denominated LTL Management LLC, concerns J&J's talc liability. That case, though, involves an additional wrinkle not present in the previous cases, attributable to preexisting asset and liability partitioning in J&J's corporate family structure and perhaps also to J&J's ultimate designs for limiting its talc liability.

Incorporated in 1887, J&J first began selling baby powder in 1894, and over the ensuing century developed a full line of baby care products. In 1972, J&J established an internal operating division for

BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter,* 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

its baby products business, and in 1972 transferred all assets of that business to a wholly-owned subsidiary, which ultimately came to be known as Johnson & Johnson Consumer, Inc. (JJCI). As early as 1997,[7] plaintiffs began suing J&J and JJCI, alleging that exposure to talc in Johnson's-brand baby powder caused cancer. The number of suits multiplied after a liability judgment in 2013, growing to over 38,000 cases currently pending. In 2018, a Missouri jury awarded 22 ovarian-cancer plaintiffs $25 million of compensatory damages each ($550 million total, reduced to $500 million on appeal) and $4.14 billion of punitive damages (reduced to $1.62 billion on appeal).[8] Then in May 2020, J&J announced that it would discontinue the sale of talc-based baby powder in the United States and Canada, and earlier this month announced that it would stop selling talc baby powder globally in 2023.

In October 2021, J&J effectuated the divisional merger that produced the BadCo now known as LTL Management, but LTL succeeded to *only* JJCI's asbestos liability, *not* that of J&J, whose corporate identity, assets, and liabilities were not divided. Only JJCI was divided into a new GoodCo (ultimately with the same JJCI name) and BadCo (LTL Management). Nonetheless, J&J also executed the funding agreement as a party, jointly and severally liable to LTL along with JJCI, for all of the JJCI asbestos liability assigned to LTL in the divisional merger. The LTL funding agreement, however, caps J&J's cumulative and aggregate liability thereunder at the fair saleable value of JJCI (free and clear of JJCI's obligations under the funding agreement) as of the date of a given funding request thereunder,[9] and that value is estimated to be roughly $61 billion.

Two days later, LTL filed Chapter 11 in the Western District of North Carolina, but that court transferred venue of the case to the District of New Jersey, and the New Jersey bankruptcy court is the one that ultimately heard and denied the motion to dismiss the case as a bad-faith filing.

THE FOURTH CIRCUIT'S STRINGENT OBJECTIVE-FUTILITY STANDARD FOR A BAD-FAITH FILING

Had the *LTL* case remained in the Western District of North Carolina, the motion to dismiss the case likely would have been easily and expeditiously denied, which was the fate of a similar motion in the *Bestwall* case.[10] That is because the Fourth Circuit has adopted the most (and what many consider an unduly[11]) stringent standard for a bad-faith filing. The Fourth Circuit "require[s] that *both* objective futility *and* subjective bad faith be shown in order to warrant dismissal[] for want of good faith in filing" Chapter 11.[12] Thus, "even if subjective bad faith in filing could properly be found, dismissal is not warranted if [objective] futility cannot also be found."[13]

The Fourth Circuit's objective futility concept appears to be simply the converse of the statutory standard set forth in Code § 1112(b)(2)(A) "that there is a reasonable likelihood that a plan will be confirmed . . . within a reasonable period of time" or applicable statutory deadlines.[14] But confirming a plan is eminently feasible in all of the Texas Two-Step bankruptcies because BadCo's bankruptcy has been engineered to, if nothing else, accomplish one thing: resolve the mass-tort liability via a bankruptcy trust mechanism established through a confirmed plan of reorganization. Moreover, the funding agreement with GoodCo is designed to ensure that there will, in fact, be sufficient funding for that trust to meet all of its obligations to the mass-tort claimants (such as they may ultimately be—much more on this below). It is extremely difficult, therefore, to conclude that Texas Two-Step bankruptcies are objectively futile.

Concluding that BadCo does have a reasonable chance of confirming a plan is apparently all it takes to fend off a bad-faith filing challenge in the Fourth Circuit,[15] which explains why all of the Texas Two-Step bankruptcy cases were filed in the Fourth Circuit. It also explains why the venue transfer in the *LTL* case was such a significant development, notwithstanding the conceptual conundrum posed by the *LTL* bankruptcy court: "The Court cannot help but ponder how a bankruptcy filing, which took place in North Carolina and most likely satisfied the good faith standards under the applicable law in that jurisdiction, suddenly morphs post-petition into a bad faith filing simply because the case travels 400 miles up I-95 to Trenton, New Jersey."[16] Of course, setting aside that space/time warp, there is really no puzzle at all: the bad-faith filing inquiry in Trenton, New Jersey, under governing Third Circuit law, is not so simple and straightforward as it is in a North Carolina bankruptcy court (applying Fourth Circuit precedent), which the *LTL* bankruptcy court's opinion amply illustrates.

SUBJECTIVE BAD FAITH

Unlike the Fourth Circuit, most courts (including the Third Circuit) conclude that a Chapter 11 case should be dismissed if it is *either* objectively futile in the sense required by the Fourth Circuit *or* the case was filed with subjective "bad faith." While there is some disagreement about the source of a bankruptcy court's authority to dismiss a Chapter 11 case as a bad-faith filing,[17] the explicit statutory standard of "cause" for dismissal under Code § 1112(b) is sufficiently elastic and open-ended[18] to subsume traditional and longstanding[19] good-faith filing requisites.[20] Indeed, the meaning of "good faith" in this context is every bit as vague and open-ended as the statutory "cause" standard itself.

The dictionary definition of "good faith" is "a state of mind indicating honesty and lawfulness of purpose."[21] The "bad faith" appellation in this context does not refer so much to dishonesty or deceit as to one's purposes in filing Chapter 11. But the "good faith" and "bad faith" characterizations, respectively, are used to directly designate lawfulness and unlawfulness of purpose in filing Chapter 11. That, however, is simply the name attached to a legal conclusion. Just what is it, though, that determines one's lawfulness and unlawfulness of purpose/s for filing Chapter 11?

The bad-faith-filing doctrine seeks to identify and bar from Chapter 11 relief those "petitioners whose aims are antithetical to the basic purposes of bankruptcy."[22] "Bad faith" Chapter 11 filings are those "that seek to achieve objectives outside the legitimate scope of the bankruptcy laws."[23] Just what are those legitimate bankruptcy purposes, though, and what purposes are illegitimate?

1. BANKRUPTCY IS ONLY APPROPRIATE AS A RESPONSE TO FINANCIAL DISTRESS

While the Third Circuit has stated that such a good-faith determination is an inherently "fact intensive inquiry,"[24] nonetheless, that court has repeatedly "focused on two inquiries that are particularly relevant to the question of good faith":[25] (1) whether "the petition serves a valid bankruptcy purpose" and (2) whether "the primary, if not sole, purpose of the filing was a litigation tactic."[26] Moreover, the thread that seems to run through and unite both of those inquiries is financial distress.

"The Bankruptcy provisions are intended to benefit those in genuine financial distress," and thus, "good faith necessarily requires some degree of financial distress on the part of a debtor."[27] The absence of any financial distress, therefore, is what often points to the conclusion that a debtor "fil[ed] a Chapter 11 petition merely to obtain tactical litigation advantages . . . not within 'the legitimate scope of the bankruptcy laws.' "[28]

Moreover, financial distress is also the mediating force between proper and improper filings for the purpose of taking advantage of "rule changes" in bankruptcy.[29] "Just as a desire to take advantage of the protections of the Code cannot establish *bad* faith as a matter of law, that desire cannot establish *good* faith as a matter of law[, g]iven the truism that every bankruptcy petition seeks some advantage offered in the Code."[30] But any given Code provision "and the legislative policy underlying that provision assume the existence of a valid bankruptcy, which, in turn, assumes a debtor in financial distress. The question of good faith [from financial distress] is therefore antecedent to the operation of" all provisions of the Bankruptcy Code.[31]

The legitimacy of Texas Two-Step bankruptcies under such a good-faith framework is highly dubious.[32]

2. WHOSE FINANCIAL DISTRESS?

As the *LTL* bankruptcy court acknowledged, a valid bankruptcy "purpose assumes an entity in distress,"[33] and the Third Circuit has indicated that "serious" distress "at the time of filing" is required.[34]

For such debtors facing serious financial distress, a Chapter 11 "petition serves a valid bankruptcy purpose, *e.g.*, by preserving a going concern or maximizing the value of the debtor's estate."[35]

Of course, the BadCo resulting from a Texas Two-Step has no business operations other than administering the mass-tort litigation to which it has succeeded. And in the case of *In re 15375 Memorial*, the Third Circuit recognized that debtors with no "business other than the handling of litigation" obviously "have no going concerns to preserve."[36]

The bankruptcy court in *LTL Management*, though, nonetheless concluded that the BadCo bankruptcy filing in that case was appropriate in order to preserve and maximize the going-concern value *not* of the BadCo debtor, LTL Management, but rather that of *nondebtors* JJCI and J&J who had not filed bankruptcy. And those nondebtor entities' going-concern value is not preserved and maximized by *filing* Chapter 11; it is preserved by *not filing* Chapter 11, thus "avoiding all of the direct and indirect costs that a bankruptcy filing would entail."[37] The *LTL* bankruptcy court elaborated, as follows:

> Filings by these companies [JJCI and J&J] would create behemoth bankruptcies, extraordinary administrative costs and burdens, significant delays and unmanageable dockets. One need only look at the conflict list in this case—revealing pages and pages of domestic and global affiliated entities and related parties—to confirm that such filings would pose massive disruptions to operations, supply chains, vendor and employee relationships, ongoing scientific research, and banking and retail relationships—just to name a few impacted areas. The administrative and professional fees and costs associated with such filings would likely dwarf the hundreds of millions of dollars paid in mega cases previously filed—and for what end? Even if Old JJCI had itself filed for bankruptcy, the talc actions would still be subject to the automatic stay, the assets available to pay those claims would be no greater, and the sole issue in the case would still be the resolution of the talc liabilities.
>
> Let me be clear, this is not a case of too big to fail . . . rather, this is a case of too much value to be wasted, which value could be better used to achieve some semblance of justice for existing and future talc victims. The Court is not addressing the needs of a failing company engaged in a forced liquidation. Instead, the J&J corporate enterprise is a profitable global supplier of health, consumer products and pharmaceuticals that employs over 130,000 individuals globally, whose families are dependent upon continued successful operations. Why is it necessary to place at risk the livelihoods of employees, suppliers, distributors, vendors, landlords, retailers—just to name a few innocent third parties—due to the dramatically increased costs and risks associated with all chapter 11 filings, when there is no palpable benefits to those suffering and their families? Clearly, the added hundreds of millions of dollars that would be spent on professional fees alone would be better directed to a settlement trust for the benefit of the cancer victims. As acknowledged by other courts, bankruptcy filings by J&J[or] JJCI would pose potential negative consequences, without offering a positive change in direction or pathway to success in this case.[38]

Correspondingly, then, the *LTL* bankruptcy court concluded that the financial distress from the talc litigation that was relevant to the good-faith inquiry was *not* that of the BadCo debtor, LTL Management, but rather was that of the *non*debtor operating companies, JJCI and J&J, that had *not* filed Chapter 11. And based upon the evidence presented, the court ultimately concluded "that the continued viability of all J&J companies is imperiled" because "J&J and . . . JJCI were in fact facing a torrent of significant talc-related liabilities for years to come."[39]

That is the strongest and most sympathetic case that can be made for the potential legitimacy of Texas Two-Step bankruptcies. ***If*** mass-tort Defendant *is* experiencing a level of financial distress that would justify a bankruptcy filing by Defendant in order to resolve its mass-tort liability in bankruptcy (more on that very big "*if*" below), then a Texas Two-Step bankruptcy,

> by isolating and separating Defendant's mass-tort liability (in a new BadCo) from its business operations (in a new GoodCo) and subjecting only the former to the bankruptcy process, the value of Defendant's business (which must ultimately pay the mass-tort obligations, under a funding agreement between GoodCo and BadCo) is enhanced by avoiding all of the direct and indirect costs that a bankruptcy filing would entail. At the same time, though, Defendant can nonetheless take advantage of bankruptcy's beneficial claims resolution process, which consolidates all of the mass-tort claims, both present and future claims, in one forum—the Bankruptcy Court.[40]

Whatever merit there is to permitting such a partial, limited restructuring as a theoretical and policy matter,[41] nonetheless, it is *not* the bankruptcy system that Congress enacted. The statutory system in place is one that requires *all* of a debtor's assets and business operations be placed under the direct jurisdiction, supervision, and control of a federal bankruptcy court.[42] That system ensures, for example, that *all* non-ordinary-course transactions must receive advance court approval,[43] with scrutiny from all creditors, to ensure that the full value of the operating business is available, first and foremost, to pay creditors' claims.[44] Moreover, that system is designed to give *all* creditors having the same relative priority rank an assurance of equal treatment. A Texas Two-Step bankruptcy, however, by only subjecting tort claimants to the bankruptcy process, essentially subordinates their claims to prior payment in full (from GoodCo) of all other creditors.[45] And most significantly (and as discussed further below), Texas Two-Step bankruptcies sanction disregard of tort claimants' right to absolute priority over equity interests.

The Texas Two-Step bankruptcy, therefore, is yet another permutation of parties and courts creating ad hoc, à la carte bankruptcies that allow those in control of the process to seriously compromise fundamental rights and protections of the "odd ones out."[46]

FILING CHAPTER 11 SOLELY TO ACCESS BANKRUPTCY'S CLAIMS-RESOLUTION PROCESS: HEREIN OF THE BAD-FAITH "LITIGATION TACTIC" BANKRUPTCY

Like the makeshift distribution-and-discharge system created via nonconsensual nondebtor release practice[47] at the root of the prominent and rapidly escalating phenomenon of "bankruptcy grifting" by nondebtors,[48] the Texas Two-Step bankruptcy selectively extends certain beneficial aspects of bankruptcy relief to an entity that has not filed bankruptcy. In particular, via the Texas Two-Step, mass-tort Defendant gains access to bankruptcy's centralized forum,

> which consolidates all of the mass-tort claims, both present and future claims, in one forum—the Bankruptcy Court.
>
> That mandatory, universal consolidation of *all* mass-tort claims, which is entirely unique to the bankruptcy process, is tremendously powerful and is a huge boon to facilitating aggregate settlement of Defendant's mass-tort exposure.[49]

Accessing bankruptcy's claims resolution system indisputably is the <u>*only*</u> objective of a Texas Two-Step bankruptcy. As the debtor acknowledged in the *LTL* case, the <u>*entire*</u> purpose of J&J's Texas Two-Step was "to enable Debtor to fully resolve talc-related claims through a chapter 11 reorganization, without subjecting the entire enterprise to a bankruptcy proceeding."[50]

> From the outset, J&J and Debtor have been candid and transparent about employing Debtor's chapter 11 filing as a vehicle to address the company's growing talc-related liability exposure and costs in defending the tens of thousands of pending ovarian cancer claims and hundreds of mesothelioma cases, as well as future claims.[51]

The *LTL* bankruptcy court enthusiastically, and at length, endorsed that objective as a perfectly legitimate, good-faith use of the bankruptcy system.[52] The Third Circuit's decision in the *15375 Memorial* case,[53] however, indicates that access to bankruptcy's centralized forum to resolve pending litigation, standing alone, is *not* a legitimate use of the bankruptcy system, particularly when that procedural maneuver is orchestrated for the benefit of nondebtor affiliates.

In *15375 Memorial*, the debtors (Memorial and Santa Fe) were subsidiaries (Memorial being a holding-company parent of only one corporation, Santa Fe, an operating company) in the GlobalSantaFe (GSF) corporate group, which is an oil and gas exploration giant. All of Santa Fe's assets were upstreamed to GSF in contemplation of a dissolution of Santa Fe. Before that dissolution could be fully effectuated, though, Santa Fe and others were sued by many individuals adversely affected by a groundwater contamination. After extensive discovery in that litigation (which exposed significant liability risk for both Santa Fe and GSF), Santa Fe and Memorial filed Chapter 11, which halted the litigation against both Santa Fe and GSF, since GSF's potential liability was derivative liability to Santa Fe.

The *15375 Memorial* debtors' only assets of any significance were insurance coverage available to pay any judgments in the groundwater litigation and derivative claims against GSF to also cover any judgments, and the only creditors of any significance were the groundwater plaintiffs and co-defendants with contribution and indemnity claims. Like the BadCo debtors in the Texas Two-Step bankruptcies, then, Memorial and Santa Fe had no "business other than the handling of litigation" and thus "no going concerns to preserve."[54] The bankruptcy court refused to dismiss the case as a bad-faith filing, reasoning that "rather than attempting to resolve the pending and future claims in various jurisdictions throughout the United States, Debtors filed the Bankruptcy Cases to resolve all claims in a centralized forum and to distribute assets to legitimate creditors in an equitable manner," which "is a perfectly legitimate bankruptcy purpose."[55]

Both the district court and the Third Circuit, though, held that the case must be dismissed, notwithstanding the debtors' severe financial distress (having been stripped of all operating assets by GSF).[56] Financial distress is, therefore, necessary for a good-faith filing but not sufficient, and even for an entity in financial distress,

> an orderly distribution of assets, standing alone, is not a valid bankruptcy purpose. "Antecedent to any such distribution is an inquiry [into] whether the petition [was] filed in good faith, i.e., whether [it] serve[d] a valid bankruptcy purpose." In other words, the creation of a central forum to adjudicate claims against the Debtors is not enough to satisfy the good faith inquiry—the Debtors must show that bankruptcy has some "hope of maximizing the value of the [Debtors' estates]."[57]

However, given that the debtors' assets were simply the right to look to others for satisfaction of tort creditors' claims, "the Debtors [could] not identify 'assets that [were] threatened outside of bankruptcy . . . but that could be preserved or maximized in' " bankruptcy.[58] Thus, "[t]he purported benefits to the Debtors' estates identified by the Bankruptcy Court . . . were based on procedural benefits gained from bankruptcy that cannot be said to have maximized the value of the debtor's estates."[59] Because the Chapter 11 petitions "would shield the [nondebtor] GSF entities from litigation," the Third Circuit reasoned that it simply could "not escape the conclusion that the filings were a litigation tactic."[60]

Precisely the same analysis seems to fully apply to Texas Two-Step bankruptcies. Chapter 11 debtor, BadCo, is simply a pass-through litigation entity that must look to a nondebtor affiliate for the payment of tort creditors' claims, and the whole purpose of the Texas Two-Step bankruptcy filing is to shield that nondebtor affiliate from the tort litigation.[61] Indeed, the "litigation tactic" conclusion seems undeniable when, obviously and admittedly, the *only* purpose and function of a Texas Two-Step bankruptcy is to access the bankruptcy forum for resolution of the mass-tort litigation. Keeping the operating company, GoodCo, out of bankruptcy absolutely ensures that the bankruptcy case is *only* about resolving the tort litigation in bankruptcy court rather than elsewhere and *nothing* else.

HOW MUCH FINANCIAL DISTRESS?

The *LTL* bankruptcy court's opinion is careful to link the legitimacy of the J&J Texas Two-Step to financial distress of J&J and JJCI. Were those entities actually experiencing a level of financial distress such that a J&J/JJCI Chapter 11 filing (without any divisional merger) would have been in good faith? It's hard to know for sure, of course, since that is a counterfactual hypothetical inquiry. But the Third Circuit has indicated that debtors are "allowed . . . to seek the protections of bankruptcy when faced with pending litigation that posed a *serious* threat to the companies' long term viability," as long as the "debtors experienced *serious* financial and/or managerial difficulties *at the time of filing*."[62]

Was the talc litigation causing both J&J and JJCI *serious* difficulties at the time of the LTL bankruptcy filing? The *LTL* bankruptcy court did not characterize it in those terms. Instead, the court quoted nonprecedential authority that minimizes the requisite level of financial distress, by emphasizing that "the Bankruptcy Code does not 'require any **particular** degree of financial distress as a condition precedent to a petition seeking relief.' "[63] Indeed, one could easily read the court's opinion as saying that the magnitude of mass-tort litigation itself is all that matters—that sufficiently massive tort litigation *always* causes a defendant " '*some*' degree of financial distress,"[64] no matter the defendant or the defendant's resources.

That is the very real danger presented by even opening the door to the Texas Two-Step bankruptcy, by indulging the kind of theoretical policy argument outlined above. There will be an inevitable, relentless pressure and temptation to water down the financial-distress requirement to such an extent that Texas Two-Step bankruptcies will be largely, if not entirely, decoupled from the problem that bankruptcy is designed to address: "when the debt overhang from massive disputed obligations presents a . . . threat to entity viability and full payment of all claimants."[65] Indeed, as discussed above, that is already the case in the Fourth Circuit, which requires *no* financial distress *at all* as a requisite to a "good faith" Chapter 11 filing.[66]

If we remove (or dilute into virtual nonexistence) any financial-distress requisite by saying that *any* mass-tort defendant can, if it wants, simply choose to have its mass-tort obligations resolved in Chapter 11, then the legitimacy of the Texas Two-Step is nothing more than a relative assessment of which forum is "better" at resolving mass torts—the bankruptcy system or the nonbankruptcy tort system? Indeed, that is precisely how the *LTL* bankruptcy court framed the ultimate inquiry for its decision:

> In evaluating the legitimacy of Debtor's bankruptcy filing, this Court must also examine a far more significant issue: which judicial system—the state/federal court trial system, or a trust vehicle established under a chapter 11 reorganization plan structured and approved by the United States Bankruptcy Court—serves best the interests of this bankruptcy estate, comprised primarily of present and future tort claimants with serious financial and physical injuries.[67]

And after a lengthy commentary on the relative merits of the bankruptcy and nonbankruptcy systems for resolution of mass torts, the *LTL* bankruptcy court concluded that the bankruptcy system is superior. Thus, the court opined that "there is nothing to fear in the migration of tort litigation out of the tort system and into the bankruptcy system"[68] and "maybe the gates indeed should be opened."[69] Most significantly, the court concluded as follows: "The Court is unpersuaded that the tort claimants have been placed in a worse position due to" the J&J Texas Two-Step; "the interests of present and future talc litigation creditors have not been prejudiced."[70]

I do not share the court's confidence in that conclusion. Many structural features of the bankruptcy system for aggregate resolution of mass-tort liability can (and likely do) produce systematic *under*compensation of mass-tort claimants relative to a nonbankruptcy baseline, particularly for future claimants. That is why it is so pernicious to positively invite and encourage solvent defendants to resolve their mass-tort obligations in bankruptcy, which *any* mass-tort defendant can (and will) do if Texas Two-Step bankruptcies are prima facie legitimate, as they are in the Fourth Circuit and perhaps also in the Third Circuit if the *LTL* decision is affirmed on appeal.

The *LTL* bankruptcy court attempted to minimize the prospects of a veritable flood of mass-tort litigation into the bankruptcy courts, but the court's prognostications are unconvincing.[71] Indeed, the July 26 Chapter 11 filing by 3M subsidiary Aearo Technologies LLC,[72] *solely* for the *admitted* purpose of shifting hundreds of thousands of earplug liability suits against Aearo and 3M, *out* of the largest federal multi-district litigation (MDL) proceeding ever and *into* bankruptcy court,[73] provides an arresting, almost-instantaneous illustration of the floodgates problem that the *LTL* bankruptcy court pooh-poohed.[74] The stated reasons for that Chapter 11 filing explicitly relied upon the authority of the *LTL* decision,[75] and conspicuously absent was any mention of financial distress for either 3M or Aearo, presumably because there is none.[76]

BANKRUPTCY SYSTEMATICALLY DISADVANTAGES MASS-TORT CLAIMANTS

Not only is a Texas Two-Step bankruptcy a baldfaced "litigation tactic" Chapter 11 filing, the shift from the nonbankruptcy tort system into the bankruptcy system for resolving mass torts systematically prejudices mass-tort claimants, particularly future claimants.

1. DEPRIVING CLAIMANTS OF DUE PROCESS "OPT OUT" RIGHTS

The most important and fundamental "rule change" that is driving defendants' desire to resolve their mass-tort obligations in bankruptcy, rather than outside bankruptcy, concerns individual claimants' most basic ownership rights in their individual claims. The Supreme Court's due process jurisprudence recognizes that a tort cause of action is property belonging to the claimant.[77] One of the most fundamental incidents of a claimant's ownership of that cause of action is control—the right to assert (or not assert) that claim in court and the right to settle (or not settle) that claim with (i.e., sell it to) the defendant.[78] Infringing claimants' property right to unfettered autonomy and control over their claims requires a compelling justification.[79]

Class action and MDL proceedings. Class actions provide a means by which a fiduciary representative can assert and (with court approval) compromise and settle the claims of others, as long as the requisites for certification of a class are met.[80] For multiple reasons, though, mass torts typically are *not* appropriate for class certification, which is the upshot of the Supreme Court's decisions in *Amchem Products, Inc. v. Windsor*[81] and *Wal-Mart Stores, Inc. v. Dukes*.[82] Most significantly, though, even if certification of a class of damages claims were appropriate, each individual claimant would retain an absolute right to "opt out" of the class-action proceedings and pursue their claims on their own, consistent with their ownership rights.[83]

The only circumstance in which damages claimants could possibly be deprived of this ownership right—and thus have a mandatory settlement of their damages claims imposed upon them, whether or not they consent to that settlement—is if the defendant's resources constitute a limited fund that is insufficient to fully satisfy the defendant's mass-tort obligations. "As the Supreme Court made clear in its *Ortiz v. Fibreboard* decision, though, if a mass-tort defendant's resources do *not* constitute a limited fund . . ., individual claimants retain an absolute constitutional right to opt out of any aggregate resolution process, as part of their due process property rights in their individual claims."[84] What's more, the Supreme Court has suggested that for the kinds of damages claims typically at issue in mass torts, even if the defendant's resources *do* constitute a limited fund, the "absence of . . . opt out violates due process"[85] Otherwise " 'limited fund' classes would emerge as the functional equivalent to bankruptcy."[86]

A so-called quasi-class action proceeding pursuant to the federal MDL statute is simply a consolidation in one federal district court "for coordinated or consolidated pretrial proceedings" "[w]hen civil actions involving one or more common questions of fact are pending in different districts."[87] Nothing in that statute, however, purports to infringe in the least individual claimants' ownership rights in their individual claims. Thus, if an MDL consolidation ultimately results in a proposed aggregate settlement of mass-tort claims (the facilitation of which is typically the overriding objective of an MDL consolidation), each individual claimant can choose whether to participate in that settlement or not.

Bankruptcy. The critical background setting against which the Texas Two-Step bankruptcy strategy is executed, therefore, is that there is *no* nonbankruptcy process by which a *solvent* defendant can impose a judicially-approved, mandatory, no-opt-outs settlement of its aggregate mass-tort liability on nonconsenting claimants. Such a process would unconstitutionally infringe individual claimants' due process rights.[88] Bankruptcy, however, is a game-changer in that regard.

Bankruptcy is designed to address the same kind of common-pool problem, or so-called "tragedy of the commons," as is a nonbankruptcy limited-fund class action, "and the binding distribution scheme effectuated by a confirmed plan of reorganization is functionally identical to the mandatory non-opt-out settlement at issue in *Ortiz*."[89]

> [A] class action settlement is extremely analogous to the binding distribution scheme effectuated by a confirmed plan of reorganization in Chapter 11, complete with a preliminary injunction analogous to bankruptcy's automatic stay, an antisuit injunction upon final approval of the settlement analogous to bankruptcy's discharge injunction, and in the case of the limited-fund class action at issue in *Ortiz*, no ability whatsoever for individual claimants to opt-out of the settlement, which is of course precisely the function of the bankruptcy discharge effectuated by confirmation of a plan of reorganization. . . .
>
> Indeed, the [Supreme] Court's descriptions of the material effects of class-action settlements are entirely accurate descriptions of the relevant effects

> of a Chapter 11 plan of reorganization. "The terms of the settlement reflect essential allocation decisions designed to confine compensation and to limit [a debtor's] liability," by "settling the validity of the claims as a whole or in groups, followed by separate proof of the amount of each valid claim and proportionate distribution of the fund."[90]

"Both systems enable a mass-tort defendant to impose a judicially-approved hard cap on their aggregate mass tort liability, without any opt-outs by nonconsenting claimants."[91]

In the nonbankruptcy context, the *Ortiz* decision prohibited such a mandatory no-opt-outs settlement in the absence of a sufficient showing that that the defendant's resources actually are a "limited fund" insufficient to fully satisfy its mass-tort obligations.[92] Thus, the Court prohibited limited-fund (no opt-outs) treatment of claimants in the absence of a limited fund. The financial-distress requisite for a good-faith Chapter 11 filing, likewise, prohibits limited-fund (no-opt-outs) treatment of claimants in the absence of a limited fund, as indicated by a sufficient "threat to entity viability and full payment of all claimants, [which are the common-pool limited-fund] problems that bankruptcy is designed to address."[93]

Mass-tort claimants have no constitutional due-process right to "opt out" of the mandatory settlement of a defendant-debtor's aggregate liability effectuated by confirmation of a Chapter 11 plan of reorganization.[94] Indeed, the Constitution itself explicitly authorizes such a mandatory no-opt-outs settlement process in the Bankruptcy Clause.[95] Nonetheless, the good-faith filing requisite for invoking the bankruptcy process must be particularly sensitive to bankruptcy's elimination of that important constitutional protection for claimants' ownership of their individual claims. Otherwise, bankruptcy becomes too easy an end-run around mass-tort claimants' constitutional due-process rights, e.g., by solvent mass-tort defendants using a Texas Two-Step bankruptcy to impose a mandatory no-opt-outs settlement (that is otherwise impermissible and unconstitutional) on nonconsenting claimants. Indeed, some scholars believe that financial distress is a constitutional requirement for Congress' exercise of its Bankruptcy Power,[96] which of course, would mean that the Fourth Circuit's good-faith filing doctrine (which does not require *any* financial distress) is unconstitutional.

The *LTL* bankruptcy court seemed to recognize that a Texas Two-Step bankruptcy, and the resulting mandatory no-opt-outs settlement power, can be used by defendants to put a hard cap on their aggregate mass-tort liability in a way that simply is not possible outside bankruptcy, but essentially dismissed that as irrelevant to the good-faith filing inquiry:

> Throughout their submissions and oral argument, Movants have decried Debtor's (and its affiliated entities') efforts to "cap" the liabilities owing the injured parties. . . . Frankly, it is unsurprising that J&J and . . . JJCI management would seek to limit exposure to present and future claims. Their fiduciary obligations and corporate responsibilities demand such actions.[97]

Be that as it may, the question for the court was whether or not a Texas Two-Step bankruptcy is a legally permissible means of doing so. If there are courts that decide the Texas Two-Step strategy is legally permissible (even for an eminently solvent mass-tort defendant, as in the Fourth Circuit), then, yes, management of *any* mass-tort defendant (even an eminently solvent one) will be duty-bound to seriously consider filing a Texas Two-Step bankruptcy. Thus, the court's response to this gambit of a manifest "litigation tactic" bankruptcy filing to impose a hard cap on aggregate mass-tort liability, unavailable outside bankruptcy, simply begs the question as to whether such a "litigation tactic" bankruptcy should be legally permissible. Third Circuit precedent (discussed above) seems to indicate that it should not.

In addition to the profound impact on claimants' constitutional due-process rights, bankruptcy's "mandatory non-opt-out settlement power works a dramatic change in a mass-tort defendant's ultimate aggregate liability and the complex bargaining dynamics by which that ultimate liability is determined."[98] Some academics hypothesize that eliminating opt-outs may, in certain circumstances, induce a mass-tort defendant to pay a "peace premium" to claimants.[99] Others, however (myself included), are extremely skeptical that such an animal actually exists in the wild and suspect that "any value created by [eliminating opt-outs] is captured entirely by [defendants] and the lead plaintiffs' lawyers who negotiate the [mandatory no-opt-outs] deal."[100] Regardless, though, there are even more structural features of the bankruptcy process that "pose[] a substantial risk of systematically undercompensating mass-tort claimants relative to a nonbankruptcy baseline, particularly for future claimants."[101]

2. ABRIDGING CLAIMANTS' ABSOLUTE PRIORITY RIGHTS

The biggest advantage that bankruptcy presents for mass-tort defendants, both solvent *and* insolvent, is the ability of equity interests to capture value at the expense of tort victims.

Class action and MDL proceedings. The baseline nonbankruptcy priority norm is that creditors are entitled to payment in full ahead of equity, which by its very nature is an interest residual to that of creditors. And there are many structural legal protections in corporate and commercial law designed to protect creditors' basic right to priority over equity interests.

Because an MDL consolidation does not abridge individual claimants' ultimate control over their individual claims, it also does not interfere with their right of priority over equity interests, and the same is true for an opt-out class action. A mandatory no-opt-outs class action, however, has great potential to violate claimants' right to priority over equity interests, as the Supreme Court recognized in *Ortiz*.

The Supreme Court in *Ortiz* held that for a mandatory no-opt-outs limited-fund class-action settlement to be appropriate, the proponents "must show that the fund is limited . . . *and* has been allocated to the claimants" by the settlement, in order to justify taking away individual claimants' ability to opt out of the process and pursue their individual claims on their own.[102] Thus, the Court struck down the mandatory no-opt-outs settlement of defendant Fibreboard's aggregate mass-tort liability in that case, not only because the proponents of the settlement "failed to demonstrate that the fund was limited," but in addition, the settlement contained "allocations of assets at odds with the concept of limited fund treatment."[103]

> Fibreboard listed its supposed entire net worth as a component of the total (and allegedly inadequate) assets available for claimants, but subsequently retained all but $500,000 of that equity for itself. On the face of it, the arrangement seems irreconcilable with the justification of necessity in denying any opportunity for withdrawal of class members whose jury trial rights will be compromised, whose damages will be capped, and whose payments will be delayed.[104]

That requirement that "the whole of the inadequate fund [i]s to be devoted to the overwhelming claims" is simply a reflection of the basic nonbankruptcy priority of creditors over equity interests and ensures that limited-fund (no opt-outs) treatment does "not give a defendant a better deal than *seriatim* litigation would have produced."[105]

Bankruptcy. The *Ortiz* Court derived its announced limitations on limited-fund class actions, including its implicit priority rule, from a variety of traditional limited-fund procedures,[106] including the equitable creditors' bill, pursuant to which a court of "equity would order a master to call for all creditors to prove their debts, to take account of the entire estate, and to apply the estate in payment of the debts."[107] Of course, the equitable creditors' bill was also the procedural vehicle used to effectuate the common-law version of corporate reorganizations, which inspired the subsequent codification of corporate reorganization procedures, culminating in our present-day Chapter 11 process.[108] And in the common-law iteration of corporate reorganizations, the Supreme Court had an extensive jurisprudence regulating the absolute priority rights of creditors over equity interests.[109]

Chapter 11 codifies significant departures from the common-law absolute priority rule. Regulation of the relative priority rights of creditors and equity interests under a Chapter 11 plan of reorganization revolves around a series of rules whose operation depends upon a scheme of classification of creditors and class voting on a proposed plan of reorganization, which in a mass-tort bankruptcy will effectuate the mandatory no-opt-outs settlement of the debtor's aggregate-mass tort liability. Most significantly, those rules permit equity holders to retain an interest in the reorganized debtor entity, even without payment in full of all creditor claims, as long as all creditor classes vote to accept the proposed plan.[110] If a creditor class does *not* vote to accept the plan, equity holders cannot receive or retain *anything* (i.e., their ownership interests must be completely wiped out) unless the plan provides for payment in full of each creditor in that rejecting class.[111]

Those are the protections for a rejecting class under Chapter 11's liberalization of the common-law absolute priority rule. The strict common-law absolute priority rule protected each and every *individual* creditor's right to priority over equity. The Chapter 11 priority rules, by contrast, protect only rejecting *classes* of creditors.[112]

Several aspects of that distribution priority scheme make it extremely advantageous to equity holders for a defendant's mass-tort obligations to be resolved in bankruptcy rather than the nonbankruptcy tort system (with its implicit rule of absolute priority), especially for a solvent defendant.

HOW EQUITY CAPTURES VALUE AT THE EXPENSE OF MASS-TORT CLAIMANTS IN BANKRUPTCY

1. "FULL PAYMENT" PLANS THAT DON'T PAY IN FULL

Note, that under the Chapter 11 priority rules, equity holders can *retain* their ownership interests, even if a class of creditors has rejected the plan, as long as "the plan provides that each holder of a claim of such [rejecting] class will receive or retain . . . property of a value . . . equal to the allowed amount of such claim."[113] That is the Code's provision for a so-called "cram down" of a rejecting class of creditors, by *either* eliminating all junior interests, such as equity, *or* by full payment of the rejecting class.

A so-called "full payment" plan, however, does not necessarily mean that each individual tort claimant will actually receive the full amount of their claim once it is eventually liquidated (by either settlement or trial). When that is the case, and when equity holders also retain ownership interests (or receive anything else) under the plan, tort claimants' loss (via less than full payment or even an increased risk thereof) is equity holders' gain—a result that could not prevail under the implicit absolute-priority rule prevailing outside bankruptcy. There are two common means by which so-called "full payment" plans can actually deny tort claimants full payment while simultaneously providing for equity holders to retain their ownership interests.

Disallowing punitive damages claims. Courts in many mass-tort bankruptcies categorically disallow any and all punitive damages claims.[114] If all claims for punitive damages are categorically disallowed, then they do not even factor into the Bankruptcy Code's cram-down calculus, at all. Thus, equity holders can retain their interests even if mass-tort claimants have voted to *reject* a proposed plan settlement *and* the debtor has engaged in conduct that would subject it to punitive damages assessments appropriately borne by equity.

That result "undermines the purposes of punitive awards by permitting a wrongdoing debtor (or a corporate debtor's shareholders) to receive" and retain value to which they simply are not entitled under applicable nonbankruptcy law, "and for no demonstrable, countervailing bankruptcy policy objective (other than taking from the [tort] creditors to give to the shareholders)."[115] And solvent mass-tort defendants' use of bankruptcy's unique mandatory settlement process to evade any liability for punitive damages is a common (although underappreciated) stratagem.[116]

Estimating "full payment" of all mass-tort claimants. When a plan of reorganization is proposed and confirmed in a mass-tort bankruptcy case, the debtor's aggregate liability to all mass-tort claimants is not yet fully determined and liquidated. Thus, the plan of reorganization will set up a "fund" (typically organized as a separate trust entity) to pay tort claimants as their individual claims are liquidated (through settlement or litigation) in the claims allowance process.[117]

Nonetheless, the debtor's aggregate liability to the mass-tort claimants must be *estimated* for purposes of determining the proposed plan's compliance with the Code's confirmation rules, such as the rule permitting cram-down of a rejecting class of mass-tort claimants because "the plan provides that each holder of a claim of such [rejecting] class receive . . . property of a value . . . equal to the allowed amount of such claim."[118] In a mass-tort bankruptcy, compliance with such a full-payment requirement would necessarily have to rely upon a judicially determined (by a preponderance of the evidence) *estimate* of the aggregate amount necessary to fully pay all mass-tort claimants the amounts at which all of their claims are ultimately allowed.[119]

With such a judicial estimate of aggregate liability in hand, then, a debtor can confirm a "full payment" plan by simply setting aside a "fund" *in that amount* for payment of the mass-tort claimants, *and no more*. That is the means by which a fully solvent mass-tort defendant can place a hard cap on its aggregate mass-tort liability in bankruptcy.[120] And it is noteworthy that *all* of the funding agreements in the Texas Two-Step bankruptcies likewise *cap* GoodCo's funding obligation at the amount necessary to pay BadCo's mass-tort obligations as determined "pursuant to a plan of reorganization for [BadCo] confirmed by final, nonappealable order of the Bankruptcy Court."[121]

The prejudice to mass-tort claimants from such a cap is obvious, given that the estimated amount may ultimately prove incorrect. Moreover, errors in setting such a cap will shortchange *only* tort claimants because it is easy enough to provide (and, of course, plans do provide) that any ultimate *surplus* in the payment trust reverts to the debtor at the end of the day. The nature of a cap, though, is that if the capped amount ultimately proves to be *insufficient*, those whose recovery is capped are simply out of luck (S.O.L. is the trade term). "Thus, when courts rely on promises or projections of full payment in approving" mandatory no-opt-outs settlements of aggregate mass-tort liability through confirmed reorganization plans, "the appeal to minimal creditor prejudice tends to ring hollow."[122]

2. THE DARK SIDE OF CLAIMANT VOTING

Equity can also capture value from tort claimants in bankruptcy by exploiting Chapter 11's class voting system, particularly given the inherent conflicts between present tort claimants and future claimants.

The two most distinctive attributes of bankruptcy's aggregative process for resolving mass-tort obligations, especially as contrasted with the nonbankruptcy tort system, are (1) its provision for a mandatory no-opt-outs settlement of aggregate liability (via the bankruptcy discharge),[123] and (2) the corollary power of voting majorities to bind dissenting minority claimants (who are barred from opting out). Many hail claimant voting as an improvement over the nonbankruptcy tort system, which has no mechanism for direct, comprehensive polling of tort creditors' approval/disapproval of a proposed aggregate settlement.[124] While claimant democracy might seem like a laudable objective, there is a (largely overlooked and unrecognized) dark side to claimant voting in bankruptcy because of its role in the operation of the Bankruptcy Code's plan confirmation and cram-down rules.

Again, there are two means by which equity can receive or retain value under a plan of reorganization: (1) provide for payment in full of any creditor class that has rejected the proposed plan (discussed above),[125] *or* (2) obtain the requisite-majority approval of the proposed plan (i.e., the settlement/fixing of the debtor's aggregate mass-tort liability) by all impaired creditor classes.[126] The claimant voting process is yet another means for equity to take value away from tort claimants in bankruptcy (especially for solvent, but also for insolvent debtors).

The Bankruptcy Code takes away individual claimants' absolute (constitutional due-process) right under applicable nonbankruptcy law to opt out of any proposed settlement of a defendant's aggregate mass-tort liability. In the place of that opt-out right, the Bankruptcy Code establishes an elaborate series of structural protections for dissenters. The ultimate legitimacy and fairness of any resulting settlement, therefore, is very much a function of the extent to which the integrity of those (seemingly technical, but critically important) structural protections are maintained.

The Code's voting rules were not designed with the expectation that they would be used to settle debtors' aggregate mass-tort liability (and, as discussed above, the implicit assumption underlying these, as well as all other Code provisions, is a debtor experiencing financial distress). Mass-tort bankruptcies, therefore, present extensive opportunities to manipulate, dilute, and even eliminate the Code's important structural protections for dissenters.

Elimination of Dollar-Weighting of Votes. Under the Bankruptcy Code's voting rules, an impaired class votes to approve a proposed plan if a majority in number, holding at least 2/3 in dollar amount, of the voting claimants in that class vote to accept the plan.[127] It is common practice in mass-tort bankruptcies that all unliquidated tort claims are placed in the same class and the dollar amount of every filed claim will be estimated, solely for purposes of voting under Bankruptcy Rule 3018(a), at $1 each.[128] Note, then, that this practice effectively eliminates the Code's dollar-weighting of claimant votes and, thereby, converts the dual-dimension (both number of creditors and dollar value of claims) voting-approval requirement into a one-dimensional two-thirds-in-number approval. In asbestos bankruptcies, to the extent that the plan contemplates entry of a § 524(g) injunction, the requisite majority is increased even further to 75% of the voting claimants,[129] but § 524(g) likewise contains no dollar-weighting of claimant votes.

Elimination of the Code's dollar-weighting of claimant votes dilutes the voting power of large-dollar claims, which is particularly significant in the context of mass-tort bankruptcies, as it is generally recognized that high-value claims may have a greater propensity to "opt out" of proposed aggregate settlements.[130] Thus, even if a plan does *not* propose to pay all mass-tort claimants in full, equity can nonetheless retain value if the plan is sufficiently generous to lower-value (or even *no-value!*) claimholders to entice the requisite majority (2/3 or 75%) to approve the plan. Equity can receive value, then, even in the face of the dissent of high-value claims (the realistic aggregate dollar-value of which may well dwarf that of the approving claimants) that will *not* be paid in full.

Capping (and Thus Reducing) Aggregate Liability by Majority Vote. That Chapter 11 voting system also presents yet another opportunity for a solvent debtor to confirm a so-called "full payment" plan that will *not* actually pay all tort claimants in full, by voting approval thereof, rather than the estimated "full payment" cram-down discussed above. The fact that a confirmed Chapter 11 plan can place a hard cap on a debtor's aggregate mass-tort liability, combined with the Code's voting scheme, allows the requisite majority of the tort claimants (2/3 or 75%) to essentially decide what that hard cap will be. As Adam Levitin has trenchantly observed, that voting process will systematically cap a debtor's aggregate mass-tort liability at an amount that is less than the aggregate settlement value that would prevail in the nonbankruptcy tort system (which cannot bind individual nonconsenting claimants to an aggregate settlement amount).[131]

Once again, then, equity holders of a solvent debtor can use the bankruptcy process to cap a debtor's aggregate mass-tort liability, even if that cap is insufficient to actually pay all tort claimants in full, and without even having to resort to the Code's cram-down provisions, as long as the plan is generous enough to a sufficient percentage of the mass-tort claimants (2/3 or 75%) to obtain a class approval. To be sure, if a solvent debtor proposes such a "full payment" plan, the court would have to find (by a preponderance of the evidence) that the proposed cap is sufficient to pay all tort claimants in full, under the plan-feasibility requirement of § 1129(a)(11). That plan-feasibility determination, though, will necessarily have to rely upon an *estimate* of the debtor's aggregate mass-tort liability, which (as discussed above) will systematically err on the side of *understating* the debtor's liability. Moreover, it is widely believed that courts are much less rigorous in scrutinizing plan feasibility in the case of a so-called consensual plan (approved by the requisite majority vote of all impaired classes).[132] That may well be appropriate in other Chapter 11 cases, but it will magnify the systematic undercompensation of mass-tort claimants in bankruptcy.

Disenfranchising Future Claimants. All of these phenomena, that (both individually and in combination) can lead to systematic undercompensation of dissenting tort claimants in bankruptcy, are especially pronounced in cases involving as-yet-uninjured future claimants, who can be completely disenfranchised *and* simultaneously deprived of *all* of the Code's cram-down protections.

"The ability to bind dissenters through a class vote makes appropriate classification the touchstone of protecting the rights of dissenters."[133] As *Bankruptcy Law Letter*'s very own Bruce Markell has aptly noted: "Behind the assumption that voting is meaningful lies the notion that some common interest exists among members of a class. Otherwise, it makes little sense to say that anything less than a unanimous vote could bind dissenters."[134] Thus, Bankruptcy Code § 1122(a) provides that "a plan may place a claim . . . in a particular class only if such claim . . . is substantially similar to the other claims . . . of such class."[135]

The Bankruptcy Code's classification and voting system is an awkward fit, at best, with classes comprised entirely of large numbers of disputed and unliquidated litigation claims, but nonbankruptcy class actions provide a helpful analogy. As previously noted, a binding resolution of a defendant's aggregate liability via class action is functionally identical "to the binding distribution scheme effectuated by a confirmed plan of reorganization in Chapter 11."[136] Moreover, class actions implicate similar classification issues, in order to ensure that the court-appointed class representatives "will fairly and adequately protect the interests of the class" because, inter alia, the representatives' claims "are typical of the claims . . . of the class" as a whole.[137] Otherwise, it makes little sense to allow a class representative to litigate, negotiate, and/or compromise class members' claims at all.

Class-action procedures, therefore, contain a requirement virtually identical to that of Bankruptcy Code § 1122(a) that a class cannot include claims that are substantially dissimilar to those of other class members.[138] The focus is "on whether a proposed class has sufficient unity" of interest.[139]

In its important *Amchem* and *Ortiz* decisions, the Supreme Court elucidated appropriate classification in the context of class-action settlements functionally identical to a confirmed plan of reorganization in that "[t]he terms of the settlement reflect essential allocation decisions designed to confine compensation and to limit [a debtor's] liability,"[140] by "settling the validity of the claims as a whole or in groups, followed by separate proof of the amount of each valid claim and proportionate distribution of the fund."[141] And in each of those decisions, the Supreme Court held that the interests of present claimants are so fundamentally divergent from those of future claimants that "it is obvious" that a settlement that purports to bind both "holders of present and future claims (some of the latter involving no [present] physical injury and [even] attributable to claimants not yet born) requires division into" separate classes in order "to eliminate conflicting interests."[142]

> In significant respects, the interests of [present claimants and future claimants] within [a] single class are not aligned. Most saliently, for the currently injured, the critical goal is generous immediate payments. That goal tugs against the interest of [future claimants] in ensuring an ample, inflation-protected fund for the future.[143]

Assuring present and especially future claimants "adequate structural protection"[144] via separate classification is equally important in bankruptcy. Indeed, the Third Circuit itself has flagged the critical importance of a Chapter 11 "Plan's treatment of current asbestos claimants relative to future asbestos claimants," relying on the "structural inadequacy" identified in *Ortiz* and grounded in the "Court's requirement of fair treatment for all claimants—a principle at the core of equity—[which] also applies in the context of [a mass-tort bankruptcy] case."[145]

The original sin of mass-tort bankruptcies is the inclusion of both present and future claimants in the same class for purposes not only of plan treatment, but also satisfaction of the plan-confirmation requirements of Code § 1129—a practice that still prevails.[146] That practice is deleterious because generally "the only . . . claimants capable of voting [are] present . . . claimants."[147] Plans that bind both present and future mass-tort claimants,

> then, predictably and systematically favor the interests of the largest number of present claimants . . . . Moreover, the primary concern of debtor companies struggling to cope with an onslaught of [mass-tort] litigation is not assuring an equitable

> distribution amongst [the mass-tort] claimants, but rather is obtaining the requisite . . . voting approval of present . . . claimants.[148]

The bias this creates against the interests of future claimants is confirmed by our now-extensive experience with asbestos bankruptcies.[149] Moreover, separate representation of and advocacy for the interests of future claimants by a future claims representative is an insufficient corrective.

> The ability of a future claims representative (FCR) to adequately represent the interests of future claimants, in general, can be hamstrung by various structural features embedded in the nature of the FCR's representative role and the Chapter 11 process. Thus, there are reasons to believe that future claimants may be systematically shortchanged in bankruptcy.[150]

Importantly, that systematic shortchanging of future claimants can inure not only to the benefit of present claimants, but also to equity holders, who can exploit bankruptcy's structural bias against future claimants to capture value from future claimants. Moreover, that is true in cases involving both solvent and insolvent debtors. Whether or not a plan proposes "full payment" of all mass-tort claimants, the Bankruptcy Code's priority and cram-down rules permit equity to receive or retain value as long as all creditor classes vote to approve the plan, including the class of mass-tort claimants, whose vote will be controlled by present claimants (because they are the only claimants capable of voting).

There is a readily available means of curbing equity holders' ability to profit at the expense of future claimants that is already embedded in the structure of the Code's confirmation rules, properly applied. To the extent that a plan will bind future claimants, Code § 1122(a) properly requires separate classification of present and future claimants, in at least two separate classes. Moreover, to the extent that future claimants simply cannot vote, a class of future claimants cannot properly be considered to have "accepted the plan" within the meaning of § 1129(a)(8),[151] which means that plan can only be confirmed if the future-claims class can be crammed down under § 1129(b). If the plan does not propose to pay all mass-tort claimants in full, then the plan can only be confirmed if equity interests receive or retain *nothing* under the plan (i.e., their interests must be wiped out).[152] This would effectively prevent equity from capturing value at the expense of future claimants in the case of an insolvent debtor. But that would require a dramatic change in the prevailing practice in mass-tort bankruptcies.

Even that change, though, would not prevent equity from taking value away from future claimants in the case of a solvent debtor. That is because the future-claims class can alternatively be crammed down if the plan provides for "payment in full" of all allowed mass-tort claims.[153] As discussed above, though, such "payment in full" plans (that cap the debtor's aggregate mass-tort liability) will systematically err on the side of *under*compensating mass-tort claimants and particularly future claimants, given bankruptcy's various structural biases against the futures.

That is the ultimate irony in the *LTL* decision, which repeatedly touted bankruptcy's supposedly superior ability to deal with future claims as compared to the nonbankruptcy tort system. In the case of both solvent and insolvent mass-tort defendants, though, bankruptcy systematically prejudices the interests of future claimants relative to their rights (some of which are constitutional) in the nonbankruptcy tort system, and for the systematic benefit of equity interests. Contrary to the assertion of the *LTL* bankruptcy court, then, there is much to fear from the ongoing "migration of mass tort litigation out of the tort system and into the bankruptcy system."[154] "Bankruptcy poses a substantial risk of systematically undercompensating mass-tort claimants relative to a nonbankruptcy baseline, particularly for future claimants."[155] Moreover, opening the door to Texas Two-Step bankruptcies at all will inevitably cause more and more mass-tort defendants to try to ratchet down as much as possible (or completely eliminate, as in the Fourth Circuit) any requisite level of financial distress, which *LTL* itself nicely illustrates, in order to justify resolving their mass-tort obligations in the hospitable refuge of the bankruptcy court.

CONCLUSION

In its seminal and important *SGL Carbon* decision regarding the fundamental illegitimacy of "litigation tactic" bankruptcies, the Third Circuit sounded the alarm on transforming bankruptcy into nothing more than an alternative forum for the resolution of mass torts:

> [W]e are cognizant that it is growing increasingly difficult to settle large scale litigation. *See, e.g., Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999); *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997). We recognize that companies that face massive potential liability and litigation costs continue to seek ways to rapidly conclude litigation to enable a continuation of their business and to maintain access to the capital markets. . . . [T]he Bankruptcy Code presents an inviting safe harbor for such companies. But this lure creates the possibility of abuse which must be guarded against to protect the integrity of the bankruptcy system and the rights of all involved in such proceedings. Allowing . . . bankruptcy under . . . circumstances [that are] a significant departure from the use of Chapter 11 to validly reorganize financially troubled businesses [invites that abuse].[156]

The Texas Two-Step bankruptcy is the apotheosis of that which the Third Circuit warned against.

ENDNOTES:

[1]The Texas Two-Step bankruptcy strategy is widely reputed to be the brainchild of Greg Gordon at Jones Day, https://www.jonesday.com/en/lawyers/g/gregory-gordon?tab=overview, who is debtor's counsel in all four of the pending Texas Two-Step cases. *See* Dan Levine & Mike Spector, *Going for Broke: How a Bankruptcy "Innovation" Halted Thousands of Lawsuits from Sick Plaintiffs*, Reuters Investigates (June 23, 2022, 2:59 p.m. GMT), https://www.reuters.com/investigates/special-report/bankruptcy-tactics-two-step/.

[2]*See* Tex. Bus. Orgs. Code § 1.002(55)(A) & tit. 1, ch. 10(A). The other states with divisional merger statutes are **Arizona**, Ariz. Rev. Stat. tit. 29, ch. 6; **Delaware**, Del. Code Ann. tit. 6, § 18-217(b)-(c); **Kansas**, Kan. Stat. Ann. § 17-7685a; and **Pennsylvania**, Pa. Cons. Stat. tit. 15, ch. 3(F).

[3]*In re* LTL Management, LLC, 637 B.R. 396 (Bankr. D. N.J. 2022).

[4]*In re* Bestwall LLC, 605 B.R. 43 (Bankr. W.D. N.C. 2019).

[5]*See In re* DBMP LLC, 2021 WL 3552350, at *1 (Bankr. W.D. N.C. 2021).

[6]*See In re* Aldrich Pump LLC, 2021 WL 3729335, at *1 (Bankr. W.D. N.C. 2021).

[7]*See* Lisa Girion, *Powder Keg: Johnson & Johnson Knew for Decades That Asbestos Lurked in Its Baby Powder*, Reuters Investigates (Dec. 14, 2018, 2:00 p.m. GMT), https://www.reuters.com/investigates/special-report/johnsonandjohnson-cancer.

[8]*See* Ingham v. Johnson & Johnson, 608 S.W.3d 663, 680, 724, Prod. Liab. Rep. (CCH) P 20934 (Mo. Ct. App. E.D. 2020), reh'g and/or transfer denied, (July 28, 2020) and transfer denied, (Nov. 3, 2020) and cert. denied, 141 S. Ct. 2716, 210 L. Ed. 2d 879 (2021).

[9]*See* Annex 2 to Declaration of John K. Kim in Support of First Day Pleadings at 4-6, *In re* LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021) [hereinafter *LTL Funding Agreement*] (Section 2(a) and definitions of "JJCI Value" and "Permitted Funding Use"). The JJCI Value cap is also increased by the value of any member distributions that JJCI makes after the divisional merger.

[10]*See supra* note 4 and accompanying text.

[11]*See, e.g.*, 7 Collier on Bankruptcy ¶ 1112.07[6][a] (Richard Levin & Henry J. Sommer eds., 16th ed. 2017).

[12]Carolin Corp. v. Miller, 886 F.2d 693, 700-01, 19 Bankr. Ct. Dec. (CRR) 1425, Bankr. L. Rep. (CCH) P 73071 (4th Cir. 1989) (emphasis added).

[13]*Id.* at 701.

[14]11 U.S.C.A. § 1112(b)(2)(A). *See, e.g.*, *In re* Premier Automotive Services, Inc., 492 F.3d 274, 280, 48 Bankr. Ct. Dec. (CRR) 112, 58 Collier Bankr. Cas. 2d (MB) 462, Bankr. L. Rep. (CCH) P 80966, 2007 A.M.C. 1535 (4th Cir. 2007) (stating that the debtor "clearly had no 'realistic possibility of an effective reorganization' " where debtor had "never filed a proposed plan of reorganization" and likely never would (quoting *Carolin*, 886 F.2d at 698)).

[15]*See, e.g.*, *Bestwall*, 606 B.R. at 49 ("Bestwall has the ability to reorganize and establish a trust that meets each of the statutory requirements . . . .").

[16]*LTL*, 637 B.R. at 406.

[17]Or whether such authority exists at all. *See, e.g.*, *In re* Victoria Ltd. Partnership, 187 B.R. 54, 27 Bankr. Ct. Dec. (CRR) 1210, Bankr. L. Rep. (CCH) P 76666 (Bankr. D. Mass. 1995); Janet Flaccus, *Have Eight Circuits Shorted? Good Faith and Chapter 11 Petitions*, 67 Am. Bankr. L.J. 401 (1993).

[18]Code § 1112(b)(4) lists various circumstances that constitute "cause" for dismissal, but explicitly provides that the list is nonexclusive by use of the term "includes" in the introductory clause. *See* 11 U.S.C.A. § 102(3) (" 'includes' and 'including' are not limiting").

[19]*See generally In re* Victory Const. Co., Inc., 9 B.R. 549, 7 Bankr. Ct. Dec. (CRR) 257, 3 Collier Bankr. Cas. 2d (MB) 655 (Bankr. C.D. Cal. 1981), order vacated, 37 B.R. 222, 11 Bankr. Ct. Dec.

(CRR) 749 (B.A.P. 9th Cir. 1984) and (rejected by, *In re* Victoria Ltd. Partnership, 187 B.R. 54, 27 Bankr. Ct. Dec. (CRR) 1210, Bankr. L. Rep. (CCH) P 76666 (Bankr. D. Mass. 1995)); Hon. Robert L. Ordin, *The Good Faith Principle in the Bankruptcy Code: A Case Study*, 38 Bus. Law. 1795 (1983).

[20]*See, e.g.*, *In re* SGL Carbon Corp., 200 F.3d 154, 162, 35 Bankr. Ct. Dec. (CRR) 116, 43 Collier Bankr. Cas. 2d (MB) 668, Bankr. L. Rep. (CCH) P 78084, 1999-2 Trade Cas. (CCH) ¶ 72739 (3d Cir. 1999) (holding that "a Chapter 11 petition is subject to dismissal for 'cause' under 11 U.S.C. § 1112(b) unless it is filed in good faith").

[21]*Good Faith*, Webster's Third New International Dictionary of the English Language, Unabridged 978 (2002).

[22]*In re* Integrated Telecom Express, Inc., 384 F.3d 108, 119, 43 Bankr. Ct. Dec. (CRR) 175, Bankr. L. Rep. (CCH) P 80168 (3d Cir. 2004).

[23]*In re* 15375 Memorial Corp. v. Bepco, L.P., 589 F.3d 605, 618 n.8, 52 Bankr. Ct. Dec. (CRR) 146, Bankr. L. Rep. (CCH) P 81652 (3d Cir. 2009) (quoting *SGL Carbon*, 200 F.3d at 165 (quoting *In re* Marsch, 36 F.3d 825, 828, 31 Collier Bankr. Cas. 2d (MB) 1285, Bankr. L. Rep. (CCH) P 76093, 30 Fed. R. Serv. 3d 585 (9th Cir. 1994))).

[24]*SGL Carbon*, 200 F.3d at 162. And "no list is exhaustive of all the factors which could be relevant when analyzing a particular debtor's good faith." *15375 Memorial*, 589 F.3d at 618-19 n.8 (quoting *SGL Carbon*, 200 F.3d at 166 n.16 (quoting *In re* Laguna Associates Ltd. Partnership, 30 F.3d 734, 738, 25 Bankr. Ct. Dec. (CRR) 1492, 31 Collier Bankr. Cas. 2d (MB) 545, Bankr. L. Rep. (CCH) P 75997, 1994 Fed. App. 0270P (6th Cir. 1994), as amended on denial of reh'g and reh'g en banc, (Sept. 9, 1994))).

[25]*Integrated Telecom*, 384 F.3d at 119-20. Moreover, the Third Circuit has also stated that whether to dismiss a Chapter 11 petition as filed in bad faith is a "decision . . . committed to the sound discretion of the bankruptcy or district court" and is thus "review[ed] for abuse of discretion." *SGL Carbon*, 200 F.3d at 159. Yet, at the same time, the Third Circuit has made clear that lower courts' decisions as to whether a given set of facts (as found by the trial court) rises to the level of a bad-faith filing receives no deference whatsoever "and is subject to plenary review because it is, essentially, a conclusion of law." *15375 Memorial*, 589 F.3d at 616.

[26]*15375 Memorial*, 589 F.3d at 618, 625 (quoting *SGL Carbon*, 200 F.3d at 165 (quoting *In re* HBA East, Inc., 87 B.R. 248, 260, 17 Bankr. Ct. Dec. (CRR) 957 (Bankr. E.D. N.Y. 1988))).

[27]*Integrated Telecom*, 384 F.3d at 120-21 (quoting Furness v. Lilienfield, 35 B.R. 1006, 1013, 11 Bankr. Ct. Dec. (CRR) 1342, 10 Collier Bankr. Cas. 2d (MB) 930 (D. Md. 1983)).

[28]*Integrated Telecom*, 384 F.3d at 120 (quoting *SGL Carbon*, 200 F.3d at 165 (quoting *Marsch*, 36 F.3d at 828)).

[29]Accessing bankruptcy to get a "rule change" unrelated to the proper purposes of bankruptcy law is one of the principal evils animating the influential "creditors' bargain theory" of bankruptcy. *See* Thomas H. Jackson, The Logic and Limits of Bankruptcy 21-27, 33, 45-46, 193-201 (1986); Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 100-01, 103-04 (1984).

[30]*Integrated Telecom*, 384 F.3d at 127-28.

[31]*Id.* at 128.

[32]*See* Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 Mich. L. Rev. Online 38, 44-47 (2022).

[33]*LTL*, 637 B.R. at 419.

[34]*SGL Carbon*, 200 F.3d at 164.

[35]*Integrated Telecom*, 384 F.3d at 120.

[36]*15375 Memorial*, 589 F.3d at 619.

[37]Ralph Brubaker, *The Texas Two-Step and Mandatory Non-Opt-Out Settlement Powers*, Harvard Law School Bankruptcy Roundtable (July 12, 2022) [hereinafter Brubaker, *Texas Two-Step*], http://blogs.harvard.edu/bankruptcyroundtable/2022/07/12/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-the-texas-two-step-and-mandatory-non-opt-out-settlement-powers/.

[38]*LTL*, 637 B.R. at 425 (citing *Aldrich Pump*, 2021WL 3729335, at *8, and *DBMP*, 2021 WL 3552350, at *8).

[39]*LTL*, 637 B.R. at 419, 421.

[40]Brubaker, *Texas Two-Step*. *See* Anthony Casey & Jonathan Macey, *A Qualified Defense of Divisional Mergers*, Harvard Law School Bankruptcy Roundtable (June 28, 2022), http://blogs.harvard.edu/bankruptcyroundtable/2022/06/28/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-a-qualified-defense-of-divisional-mergers/.

[41]In 2014 and 2015, the National Bankruptcy Conference proposed statutory amendments that would codify a new chapter of the Bankruptcy Code for such a limited, partial restructuring of bond debt. *See* National Bankruptcy Conference, Report of the National Bankruptcy Conference Adopted at the 2014 Annual Meeting: Proposal for a New Chapter for Restructuring Bond and Credit Agreement Debt (Chapter 16) (2014); National Bankruptcy Conference, Proposal for a New Chapter 16 of the Bankruptcy Code for the Restructuring of Bond and Credit Agreement Debt (Dec. 18, 2015). Both proposals are available here: http://nbconf.org/wp-content/uploads/2015/07/Proposed-Amendments-to-Bankruptcy-Code-to-Facilitate-Restructuring-of-Bond-and-Credit-Agreement-Debt.pdf.

[42]*See* 28 U.S.C.A. § 1344(e)(1).

[43]*See* 11 U.S.C.A. §§ 363-365.

[44]By contrast, for example, the only protection the LTL funding agreement provides in that regard, is that the cap on J&J's funding obligation (at no more than the value of JJCI) is increased to the extent of any JJCI member distributions. *See LTL Funding Agreement* at 4-5, 7 (definition of "JJCI Value" and Section 2(a)).

[45]There is a substantial scholarly consensus, however, that the opposite should prevail (as a theoretical and policy matter) and all other creditors should be subordinated to prior payment in full of tort victims. *See* Vincent S.J. Buccola & Joshua Macey, *Claim Durability and Bankruptcy's Tort Problem*, 38 Yale J. on Reg. 766, 781-83 (2021) (reviewing the literature).

[46]*See generally* Vincent S.J. Buccola, *Unwritten Law and the Odd Ones Out*, 131 Yale L.J. 1559 (2022) (reviewing Douglas G. Baird, The Unwritten Law of Corporate Reorganizations (2022)).

[47]*See generally* Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L.J.F. 960 (2022).

[48]*See* Lindsey D. Simon, *Bankruptcy Grifters*, 131 Yale L.J. 960 (2022).

[49]Brubaker, *Texas Two-Step*. *See* Brubaker, 131 Yale L.J.F. at 995-98.

[50]*LTL*, 637 B.R. at 404.

[51]*Id.* at 407.

[52]*See id.* at 406-17.

[53]Curiously, the *LTL* bankruptcy court did not attempt to distinguish (or even discuss the relevance of) the *15375 Memorial* decision.

[54]*15375 Memorial*, 589 F.3d at 619.

[55]*In re* 15375 Memorial Corp., 382 B.R. 652, 684, 166 O.G.R. 162 (Bankr. D. Del. 2008), order clarified on reconsideration, 386 B.R. 548, 168 O.G.R. 365 (Bankr. D. Del. 2008), rev'd, 400 B.R. 420, 168 O.G.R. 374 (D. Del. 2009), aff'd, 589 F.3d 605, 52 Bankr. Ct. Dec. (CRR) 146, Bankr. L. Rep. (CCH) P 81652 (3d Cir. 2009).

[56]The bankruptcy court found that the debtors' estates were administratively insolvent. *See 15375 Memorial*, 382 B.R. at 679-81.

[57]*15375 Memorial*, 589 F.3d at 622.

[58]*Id.* at 621.

[59]*Id.* at 625.

[60]*Id.* at 626.

[61]Indeed, the *LTL* bankruptcy court fully acknowledged that the manner in which the divisional merger and funding agreements were structured "on the eve of the bankruptcy filing [was] for the very purpose of extending the stay" of litigation to nondebtors J&J and JJCI. *In re* LTL Management, LLC, 638 B.R. 291, 306 (Bankr. D. N.J. 2022).

[62]*SGL Carbon*, 200 F.3d at 164 (emphasis added).

[63]*LTL*, 637 B.R. at 420 (quoting *In re* General Growth Properties, Inc., 409 B.R. 43, 61, 51 Bankr. Ct. Dec. (CRR) 280, 62 Collier Bankr. Cas. 2d (MB) 279 (Bankr. S.D. N.Y. 2009) (quoting U.S. v. Huebner, 48 F.3d 376, 379, Bankr. L. Rep. (CCH) P 76331, 95-1 U.S. Tax Cas. (CCH) P 50008, 74 A.F.T.R.2d 94-7427 (9th Cir. 1994) (bolded emphasis in *LTL* opinion))).

[64]*LTL*, 637 B.R. at 420 (emphasis added) (quoting *Integrated Telecom*, 384 F.3d at 121).

[65]Brubaker, *Texas Two-Step*.

[66]Even in the Fourth Circuit, though, because of the requirement that a debtor submit *all* of its assets and business operations to the direct jurisdiction and control of the bankruptcy court, the attendant direct and indirect costs of doing so provides some measure of self-regulating control on "litigation tactic" filings: the expected gains to those exercising the filing decision must exceed the expected bankruptcy costs they would suffer. The Texas Two-Step maneuver, though, by reducing the costs from a bankruptcy filing also reduces their deterrence of "litigation tactic" filings.

[67]*LTL*, 637 B.R. at 406.

[68]*Id.* at 414.

[69]*Id.* at 428.

[70]*Id.* at 422, 423.

[71]*See id.* at 428. The court reasoned as follows:

> Argument has been put forward . . . that allowing this case to proceed will inevitably "open the floodgates" to similar machinations and chapter 11 filings by other companies defending against mass tort claims. [F]or most companies, the complexity, necessary capital structure, and financial commitments required to lawfully implement a corporate restructuring as done in this case, will limit the utility of the "Texas Two-Step." Not many debtors facing financial hardships have an independent funding source willing and capable of satisfying the business's outstanding indebtedness.

LTL, 637 B.R. at 428. The floodgates fear, however, is *not* so much attributable to defendants "facing financial hardship." The concern is more about eminently *solvent* mass-tort defendants employing the Texas Two-Step strategy. A solvent mass-tort defendant, by definition, has the capability of paying all of its debts, including its mass-tort obligations and, therefore, can (also by definition) fully fund all of the obligations of the BadCo debtor it creates out of itself via a divisional merger. And now that the playbook has been opened to the world, *any* competent legal team could easily execute the Texas Two-Step for *any* mass-tort defendant, particularly a solvent one.

[72]*See* Andrew Scurria & Alexander Gladstone, *3M Shifts Mass Earplug Claims to Bankruptcy Court, Its Favored Forum*, Wall Street Journal Pro Bankruptcy (July 26, 2022 9:31 p.m. ET), https://www.wsj.com/articles/3m-shifts-mass-earplug-claims-to-bankruptcy-court-its-favored-forum-11658885474; James Nani & Alex Wolf, *3M Unit Gets Debtor-Friendly Bankruptcy Venue in Indianapolis*, Bloomberg Law (July 28, 2022 4:01 a.m.), https://news.bloomberglaw.com/bankruptcy-law/3m-unit-gets-debtor-friendly-bankruptcy-venue-in-indianapolis; Adam Levitin, *3M's Aearo Technologies' Bankruptcy: The Hoosier Hop*, Credit Slips (July 26, 2022 7:27 p.m.), https://www.creditslips.org/creditslips/2022/07/3ms-aearo-technologies-bankruptcy-the-hoosier-hop.html.

[73]*See* Information Br. of Aearo Techs. LLC at 42-57, *In re* Aearo Techs. LLC, No. 22-02890-JJG-11 (Bankr. S.D. Ind. July 26, 2022) [hereinafter *Aearo Information Br*.].

[74]*See LTL*, 637 B.R. at 428. It is also yet another illustration of the rapidly accelerating "bankruptcy grifter" phenomenon fueled by nonconsensual nondebtor releases, which "is causing a migration of mass tort litigation out of the tort system and into the bankruptcy system." Brubaker, 131 Yale L.J.F. at 992. *See Aearo Information Br*. at 57 (stating that a "cornerstone" of the "ultimate objective" of the Chapter 11 case is "a permanent channeling injunction and a third-party release of 3M" applicable to "all [earplug]-related claims" by "all potential [earplug] plaintiffs").

[75]*See* Debtor's Complaint at 2, *In re* Aearo Techs. LLC, Case No. 22-02890-11, Adv. Proc. No. 22-50059 (Bankr. S.D. Ind. July 26, 2022) (quoting *LTL*, 637 B.R. at 411) ("Addressing mass torts through a legislative scheme enacted by Congress within the bankruptcy system . . . provides a judicially accepted means of aggregating and resolving mass tort claims.").

[76]*See Aearo Information Br*. Indeed, the district-court judge presiding over the MDL proceedings contemporaneously characterized 3M as "a perfectly solvent defendant." Tr. of Show Cause Hearing and Status Conference at 16, *In re* 3M Combat Arms Earplub Prods. Liab. Litig., No. 3:19md2885 (N.D. Fla. July 27, 2022).

[77]*See* Tulsa Professional Collection Services, Inc. v. Pope, 485 U.S. 478, 485, 108 S. Ct. 1340, 99 L. Ed. 2d 565 (1988) ("a cause of action is a species of property . . . deserving due process protections").

[78]"[T]he authority that each [claimant] retains over the disposition of her right to sue . . . stems from notions of property—the premise that the client's right to sue is *her* right." Richard A. Nagareda, Mass Torts in a World of Settlement 60 (2007). *See generally* Ryan C. Williams, *Due Process, Class Action Opt Outs, and the Right Not to Sue*, 115 Colum. L. Rev. 599, 618-44 (2015).

[79]*See* Ortiz v. Fibreboard Corp., 527 U.S. 815, 846, 119 S. Ct. 2295, 144 L. Ed. 2d 715, 43 Fed. R. Serv. 3d 691 (1999) ("the burden of justification rests on the exception").

[80]*See* Fed. R. Civ. P. 23.

[81]Amchem Products, Inc. v. Windsor, 521 U.S. 591, 117 S. Ct. 2231, 138 L. Ed. 2d 689, 37 Fed. R. Serv. 3d 1017, 28 Envtl. L. Rep. 20173 (1997).

[82]Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 131 S. Ct. 2541, 180 L. Ed. 2d 374, 112 Fair Empl. Prac. Cas. (BNA) 769, 94 Empl. Prac. Dec. (CCH) P 44193, 161 Lab. Cas. (CCH) P 35919, 78 Fed. R. Serv. 3d 1460 (2011).

[83]*See* Fed. R. Civ. P. 23(b)(3) & (c)(2)(B)(v).

[84]Brubaker, *Texas Two-Step*. *See Ortiz*, 527 U.S. at 846-48.

[85]*Wal-Mart*, 564 U.S. at 362-63.

[86]*Ortiz*, 527 U.S. at 843 (quoting Henry Paul Monaghan, *Antisuit Injunctions and Preclusion Against Absent Nonresident Class Members*, 98 Colum. L. Rev. 1148, 1164 (1998)). Indeed, the mandatory no-opt-outs aspect of limited-fund class actions is functionally identical to a bankruptcy discharge, which is a foundational pillar of Congress' constitutional Bankruptcy Power. "The 'great' discharge power, in particular, provided the impetus for inclusion of the Bankruptcy Clause in the Constitution." Brubaker, 131 Yale L.J.F. at 977.

[87]28 U.S.C.A. § 1407(a).

[88]And such a process in federal court also "compromises their Seventh Amendment [jury trial] rights without their consent." *Ortiz*, 527 U.S. at 846.

[89]Brubaker, *Texas Two-Step*. Indeed, the two procedures share a common ancestry in the equitable receivership proceeding initiated by a creditors' bill filed in a federal district court. *See Ortiz*, 527 U.S. at 832-41 (describing the precursors to Rule 23(b)(1)(B) limited-fund class actions as including creditors' bill cases, such as the railroad equitable receivership in Nashville & Decatur R.R. Co. v. Orr, 85 U.S. (18 Wall.) 471 (1873)); Ralph Brubaker *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 Wm. & Mary L. Rev. 743, 832-34 (2000) (describing the origins of Chapter 11 corporate reorganizations in the equitable receivership process initiated by a creditors' bill).

[90]Ralph Brubaker, *Back to the Future Claim: Due Process in and Beyond the Mass Tort Reorganization (Part II)*, 35 Bankr. L. Letter No. 1, at 1, 11 (Jan. 2015) (footnotes omitted) (quoting *Ortiz*, 527 U.S. at 835 n.15 and *Amchem*, 521 U.S. at 627).

[91]Brubaker, *Texas Two-Step*.

[92]*See Ortiz*, 527 U.S. at 848-53.

[93]Brubaker, *Texas Two-Step*.

[94]*See* Taylor v. Sturgell, 553 U.S. 880, 895, 128 S. Ct. 2161, 171 L. Ed. 2d 155, 36 Media L. Rep. (BNA) 1801 (2008) (quoting Martin v. Wilks, 490 U.S. 755, 762 n.2, 109 S. Ct. 2180, 104 L. Ed. 2d 835, 49 Fair Empl. Prac. Cas. (BNA) 1641, 50 Empl. Prac. Dec. (CCH) P 39052, 14 Fed. R. Serv. 3d 1 (1989) ("where a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants, as for example in bankruptcy or probate, legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process")). *See generally* Brubaker, 131 YALE L.J. at 995-98.

[95]"At the heart of Congress's Bankruptcy Power is determining the appropriate distribution of someone's assets that warrants discharge of their obligations." Brubaker, 131 YALE L.J. at 978.

[96]*See, e.g.*, Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1076-89, 1093-95 (2002) ("I conclude that the 'subject of Bankruptcies' means the subject of adjusting the existing relationship between a debtor who is insolvent in some sense and the debtor's creditors.").

[97]*LTL*, 637 B.R. 416.

[98]Brubaker, *Texas Two-Step*.

[99]*See generally* Francis E. McGovern & William B. Rubenstein, *The Negotiation Class: A Cooperative Approach to Class Actions Involving Large Stakeholders*, 99 TEX. L. REV. 73, 104-06 (2020) (summarizing the literature).

[100]Brubaker, 131 YALE L.J.F. at 993.

[101]Brubaker, *Texas Two-Step*.

[102]*Ortiz*, 527 U.S. at 821.

[103]*Id.* at 848.

[104]*Id.* at 859-60 (footnote omitted).

[105]*Id.* at 839.

[106]*See id.* at 832-48.

[107]*Id.* at 837 n.17 (citing 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE §§ 547-548 (I. Redfield 8th rev. ed. 1861)).

[108]*See* Brubaker, 41 WM. & MARY L. REV. at 932-34.

[109]*See generally* Ralph Brubaker, *Inter-Class Give-Ups in a Chapter 11 Plan of Reorganization: Remembering the Origins of the Absolute Priority Rule*, 25 BANKR. L. LETTER No. 6, at 1 (June 2005).

[110]*See* 11 U.S.C.A. § 1129(a)(8).

[111]*See id.* § 1129(b)(2)(B).

[112]*See* Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership, 526 U.S. 434, 444-49, 119 S. Ct. 1411, 143 L. Ed. 2d 607, 34 Bankr. Ct. Dec. (CRR) 329, 41 Collier Bankr. Cas. 2d (MB) 526, Bankr. L. Rep. (CCH) P 77924 (1999).

[113]11 U.S.C.A. § 1129(b)(2)(B)(i).

[114]*See* Ralph Brubaker, *Punitive Damages in Chapter 11: Of Categorical Disallowance, Equitable Subordination, and Subordination by Classification*, 25 BANKR. L. LETTER No. 7, at 1, 3-5 (July 2005).

[115]*Id.* at 2, 4.

[116]*See id.* at 3-4 (discussing the disallowance of punitive damages claims in the Dalkon Shield contraceptive mass-tort bankruptcy of A.H. Robins and in the silicone gel breast implant mass-tort bankruptcy of Dow Corning); Brubaker, 131 YALE L.J.F. at 993 n.140 (discussing the air-bag mass-tort bankruptcy of Takata and how the mandatory no-opt-outs settlement produced by "nonconsensual nondebtor releases for Honda/Acura and Nissan/Infiniti gave them immunity from any liability for punitive damages").

[117]*See* Brubaker, 131 YALE L.J.F. at 996.

[118]11 U.S.C.A. § 1129(b)(2)(B)(i).

[119]*See In re* Dow Corning Corp., 211 B.R. 545, 572-73 (Bankr. E.D. Mich. 1997). As another example, if a plan provides for payment in full of all allowed tort claims, an estimate of the debtor's aggregate mass-tort liability is also necessary to determine compliance with the plan-feasibility requirement of Code § 1129(a)(11).

[120]*See* Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 987-88 n.102 (discussing the cap on aggregate mass-tort liability under the "full payment" plan in the *A.H. Robins* case); Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate Over Non-Debtor Releases in Chapter 11 Reorganizations*, 23 EMORY BANKR. DEV. J. 13, 83-84 (2006) (discussing the caps on aggregate mass-tort liability under the "full payment" plans in the *A.H. Robins* and *Dow Corning* cases).

[121]*LTL Funding Agreement* at 6. *See also* Exhibit A to Notice of Filing Annex 2 to Debtor's Submission in Lieu of Live Testimony at 5, *In re* Bestwall LLC, No. 17-31795 (Bankr. W.D.N.C. Oct. 13, 2018); Exhibit A to Stipulation Between the Debtor and CertainTeed LLC Regarding Second Amended Funding Agreement at 6, *In re* DBMP LLC, No. 20-30080 (Bankr. W.D.N.C. Jan. 5, 2022); Declaration of Ray Pittard in Support of First Day Pleadings at 29-30, 48-49, *In re* Aldrich Pump LLC, No. 20-30608 (Bankr. W.D.N.C. June 18, 2020) (definitions of "Permitted Funding Use" and "Section 524(g) Plan" and Section 2(e)).

[122]Brubaker, 1997 U. ILL. L. REV. at 987-88 n.102.

[123]*See* Brubaker, 131 YALE L.J.F. at 995-98.

[124]*See, e.g.*, S. Elizabeth Gibson, CASE STUDIES OF MASS TORT LIMITED FUND CLASS ACTION SETTLEMENTS &

BANKRUPTCY REORGANIZATIONS 5-6 (2000); Troy A. McKenzie, *Toward a Bankruptcy Model for Nonclass Aggregate Litigation*, 87 N.Y.U. L. REV. 960, 1016-19 (2012).

[125]*See* 11 U.S.C.A. § 1129(b)(2)(B)(i).

[126]*See id.* § 1129(a)(8) & (b)(1).

[127]*See id.* § 1126(c).

[128]This was the procedure established in the *Johns-Manville* case, which was an early, seminal mass-tort bankruptcy under the Bankruptcy Code. *See In re* Johns-Manville Corp., 68 B.R. 618, 631 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd*, 843 F.2d 636, 646-49 (2d Cir. 1988).

[129]*See* 11 U.S.C.A. § 524(g)(2)(B)(ii)(IV)(bb).

[130]*See* McGovern & Rubenstein, 99 TEX. L. REV. at 85-90.

[131]*See Amicus Curiae* Br. of Adam J. Levitin at 30-33, *In re* Purdue Pharma L.P., No. 22-110 (2d Cir. Mar. 21, 2022).

[132]*See* Steven H. Case, *Some Confirmed Chapter 11 Plans Fail: So What?*, 47 B.C. L. REV. 59, 64-65 (2005); Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 189 (2004); Michael St. James, *Why Bad Things Happen in Large Chapter 11 Cases: Some Thoughts About* Courting Failure, 7 TRANSACTIONS: TENN. J. BUS. L. 169, 182-84 (2005).

[133]Brubaker, 1997 U. ILL. L. REV. at 986.

[134]Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1, 12-13 (1995).

[135]11 U.S.C.A. § 1122(a).

[136]Brubaker, 35 BANKR. L. LETTER No. 1, at 11.

[137]FED. R. CIV. P. 23(a)(3)-(4).

[138]"The adequacy-of-representation requirement 'tend[s] to merge' with the . . . typicality criteria of Rule 23(a), which 'serve as guideposts for determining whether . . . the class claims are so interrelated that the interests of the class members' " are substantially the same. *Amchem*, 521 U.S. at 626 n.20 (quoting General Telephone Co. of Southwest v. Falcon, 457 U.S. 147, 157 n. 13, 102 S. Ct. 2364, 72 L. Ed. 2d 740, 28 Fair Empl. Prac. Cas. (BNA) 1745, 29 Empl. Prac. Dec. (CCH) P 32781, 34 Fed. R. Serv. 2d 371 (1982)).

[139]*Amchem*, 521 U.S. at 621.

[140]*Id.* at 627.

[141]*Ortiz*, 527 U.S. at 835 n.15.

[142]*Id.* at 856.

[143]*Amchem*, 521 U.S. at 626.

[144]*Ortiz*, 527 U.S. at 864.

[145]*In re* Combustion Engineering, Inc., 391 F.3d 190, 242 & n.57, 245, 43 Bankr. Ct. Dec. (CRR) 271, Bankr. L. Rep. (CCH) P 80206 (3d Cir. 2004), as amended, (Feb. 23, 2005).

[146]Adam and Eve ate the apple in the *Manville* case, "by declining to classify future claimants explicitly and then relying on the present claimants' overwhelming acceptance of the plan as a rough proxy for the interests of future claimants." Troy A. McKenzie, *The Mass Tort Bankruptcy: A Pre-History*, 5 J. TORT L. 59, 75 (2012).

[147]Ralph Brubaker, *Unwrapping Prepackaged Asbestos Bankruptcies (Part II): The Antithesis of Creditor Equality*, 25 BANKR. L. LETTER No. 2, at 1, 6 (Feb. 2005). "[T]he absence of future claimants . . . presents a difficult problem for achieving meaningful consent, because they cannot participate in the voting that is central to the plan confirmation process." McKenzie, 5 J. TORT. L. at 75.

[148]*Id.*

[149]*See generally* PETER KELSO & MARC SCARCELLA, DUBIOUS DISTRIBUTION: ASBESTOS BANKRUPTCY TRUST ASSETS AND COMPENSATION (Mar. 2018); S. Todd Brown, *How Long Is Forever This Time? The Broken Promise of Bankruptcy Trusts*, 61 BUFF. L. REV. 537 (2013).

[150]Brubaker, 25 BANKR. L. LETTER No. 2, at 5. *See generally* Samir D. Parikh, *The New Mass Torts Bargain*, 90 FORDHAM L. REV. (forthcoming 2022), https://ssrn.com/abstract=3649611; Mark D. Plevin, Leslie A. Epley & Clifton S. Elgarten, *The Future Claims Representative in Prepackaged Asbestos Bankruptcies: Conflicts of Interest, Strange Alliances, and Unfamiliar Duties for Burdened Bankruptcy Courts*, 62 N.Y.U. ANN. SURV. AM. L. 271 (2006); Frederick Tung, *The Future Claims Representative in Mass Tort Bankruptcy: A Preliminary Inquiry*, 3 CHAPMAN L. REV. 43 (2000).

[151]11 U.S.C.A. § 1129(a)(8). Although there is some uncertainty in the case law regarding the implications of an impaired class for which *none* of the holders of claims in that class have cast a vote on the plan, at least in this particular context, protection of the relative priority rights of future claimants (vis-à-vis both present claimants and equity interests) would seem to compel the conclusion that a class of future claimants (who are unable to participate in the plan process at all) simply cannot be *presumed* to have accepted the plan and, thus, should be entitled to the full panoply of cramdown protections.

[152]*See* 11 U.S.C.A. § 1129(b)(2)(B). That should also be the result in asbestos cases where the plan does not provide for full payment of all future asbestos claims, notwithstanding the fact that § 524(g)(2)(B)(i) only requires that, at a minimum, the trust established to pay future claimants must own a majority of the voting shares of the reorganized debtor entity, i.e., prebankruptcy equity can

retain 49.9% ownership. Nothing in § 524(g), however, even purports to displace or override any of the basic confirmation requirements of §§ 1122(a) or 1129. Rather, if a debtor wants the *additional* relief afforded by § 524(g), "[t]o achieve this relief, a debtor must satisfy the prerequisites set forth in § 524(g) *in addition to* the standard plan confirmation requirements." *Combustion Eng'g*, 391 F.3d at 234 (emphasis added and footnotes omitted).

[153] *See id.* § 1129(b)(2)(B)(i).

[154] Brubaker, 131 YALE L.J.F. at 992.

[155] Brubaker, *Texas Two-Step*.

[156] *SGL Carbon*, 200 F.3d at 169.

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Bankruptcy Law Letter

APRIL 2023 | VOLUME 43 | ISSUE 4

ASSESSING THE LEGITIMACY OF THE "TEXAS TWO-STEP" MASS-TORT BANKRUPTCY (PART II)

*By Ralph Brubaker**

INTRODUCTION

The Third Circuit abruptly disrupted the Texas Two-Step mass-tort bankruptcy strategy with its recent decision of *In re LTL Management* ("*LTL I*"),[1] ordering dismissal of the Chapter 11 case filed (in bad faith, the court held) by the Johnson & Johnson (J&J) entity, LTL Management, formed to succeed to all of the corporate talc liability. Less than three hours after that case was dismissed by the bankruptcy court, though, LTL filed a new Chapter 11 case in the same district, which case was assigned to the same bankruptcy judge that had just dismissed the first LTL case.

Before the Third Circuit's *LTL I* decision, I set forth my views on the legitimacy of the Texas Two-Step maneuver in the August 2022 issue of *Bankruptcy Law Letter*.[2] *LTL I* raises intriguing questions about the continuing viability of the Texas Two-Step bankruptcy as a means of resolving mass-tort liability, and the second LTL filing ("*LTL II*") provides a concrete case study in which to explore some of those questions. First, though, let us set the stage for that analysis by reviewing the so-called Texas Two-Step bankruptcy strategy, in general, and why the Third Circuit held that LTL's initial Chapter 11 case was filed in bad faith.

The most obvious aspect of the Third Circuit's *LTL I* holding is that the financial-distress requirement for a good-faith Chapter 11 filing *only* applies to the corporate entity that has actually filed a petition, and *not* affiliated entities who have not themselves filed bankruptcy. Less apparent, but likely of even *more* importance for the continuing viability of Texas Two-Step bankruptcies going forward (including *LTL II*), the Third Circuit *rejected* the view that exposure to a sufficiently massive number of present and future tort claims is, ipso facto, sufficient financial distress to justify a Chapter 11 filing to resolve that mass-tort liability.

*The author is a consultant to counsel for one of the participants in a pending Texas Two-Step mass-tort bankruptcy case. The views expressed herein are solely his own.

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THE "TEXAS TWO-STEP" MASS-TORT BANKRUPTCY

The "Texas Two-Step" mass-tort bankruptcy[3] proceeds essentially as follows:

Step 1. Mass-tort Defendant uses a state divisional merger statute (Texas's[4] has been the eponymous statute of choice) to divide itself into two new companies, GoodCo and BadCo. BadCo takes on all of Defendant's mass-tort liability, but also receives the benefit of a funding agreement whereby GoodCo agrees to pay all of the mass-tort obligations allocated to BadCo. GoodCo receives substantially all of Defendant's operating business and other assets and liabilities *except* the mass-tort liability, which is replaced by GoodCo's obligations under the funding agreement with BadCo.

Step 2. BadCo files Chapter 11, but GoodCo continues Defendants' business operations without filing bankruptcy. Thus, the mass-tort liability is resolved through the Chapter 11 process without having to put the business in bankruptcy.

Four such Texas Two-Step bankruptcies have been filed in recent years, three of which are still pending. To date, the only case that has been dismissed was LTL's initial Chapter 11 filing.[5] LTL's second filing adds a "Hail Mary" (or perhaps more properly, a trick play) to the playbook, in an attempt to salvage J&J's bankruptcy stratagem for resolving its talc liability.

1. BESTWALL (FROM GEORGIA-PACIFIC), DBMP (FROM CERTAINTEED), ALDRICH PUMP AND MURRAY BOILER (FROM TRANE)

All of the Texas Two-Step bankruptcies have been asbestos-liability cases involving very large, well-known companies. The first came from Georgia-Pacific, one of the world's leading makers of tissue, pulp, packaging, and building products, whose asbestos liabilities are attributable to its 1965 acquisition of Bestwall Gypsum Co., and thereafter, Georgia-Pacific continued to manufacture and sell the Bestwall asbestos-containing products, principally joint compound. In a 2017 divisional merger, Georgia-Pacific spun off its asbestos liability into a BadCo named BestWall LLC, which filed Chapter 11 in the Western District of North Carolina about one month later. The official asbestos claimants' committee filed a motion to dismiss the case as a bad-faith filing, but that motion was denied.[6] And all of the subsequent Texas Two-Step bankruptcies were then also filed in the Western District of North Carolina.

The second Texas Two-Step case involves CertainTeed, a building products manufacturer whose asbestos liability is attributable to various piping and roofing products. Its October 2019 divisional merger produced a new BadCo named DBMP LLC, which filed Chapter 11 in the Western District of North Carolina three months later in January 2020.[7] A few months later, in May 2020, the two

BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter,* 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

parents in the Trane corporate family, manufacturers of HVAC systems, shunted their respective asbestos liabilities (via divisional mergers) into two new BadCos named Aldrich Pump LLC and Murray Boiler LLC, which filed their Chapter 11 petitions in the Western District of North Carolina seven weeks later, in June 2020.[8]

2. J&J BEGETS LTL MANAGEMENT

The most recent and visible Texas Two-Step bankruptcy, of the BadCo denominated LTL Management, LLC, concerns J&J's talc liability. That case, though, involves an additional wrinkle not present in the previous cases, attributable to preexisting asset and liability partitioning in J&J's corporate family structure (and perhaps also to J&J's ultimate designs for limiting its talc liability)—one that figured prominently in the Third Circuit's dismissal decision in *LTL I*.

Incorporated in 1887, J&J first began selling baby powder in 1894, and over the ensuing century developed a full line of baby care products. In 1972, J&J established an internal operating division for its baby products business, and in 1979 transferred all assets of that business to a wholly-owned subsidiary, which ultimately came to be known as Johnson & Johnson Consumer, Inc. (JJCI). As early as 1997,[9] plaintiffs began suing J&J and JJCI, alleging that exposure to talc in Johnson's-brand baby powder caused cancer. The number of suits multiplied after a liability judgment in 2013, growing to over 38,000 cases currently pending. In 2018, a Missouri jury awarded 22 ovarian-cancer plaintiffs $25 million of compensatory damages each ($550 million total, reduced to $500 million on appeal) and $4.14 billion of punitive damages (reduced to $1.62 billion on appeal).[10] Then in May 2020, J&J announced that it would discontinue the sale of talc-based baby powder in the United States and Canada, and in August 2022 announced that it would stop selling talc baby powder globally this year.

In October 2021, J&J effectuated the divisional merger that produced the BadCo now known as LTL Management, but LTL succeeded to *only* JJCI's asbestos liability, *not* that of J&J, whose corporate identity, assets, and liabilities were not divided. Only JJCI ("Old JJCI") was divided into a new GoodCo (ultimately with the same JJCI name, "New JJCI") and BadCo (LTL Management). Nonetheless, J&J also executed the funding agreement as a party, jointly and severally liable to LTL along with New JJCI, for all of the JJCI asbestos liability assigned to LTL in the divisional merger. The funding agreement capped J&J's cumulative and aggregate liability thereunder at the fair saleable value of New JJCI (free and clear of New JJCI's obligations under the funding agreement) as of the date of a given funding request thereunder.[11] The minimum floor for that funding obligation, though, was set at the value of New JJCI on the date of the divisional merger,[12] and that value was estimated to be roughly $61.5 billion.

Two days later, LTL filed Chapter 11 in the Western District of North Carolina, but that court transferred venue of the case to the District of New Jersey, and the New Jersey bankruptcy court is the one that ultimately heard and denied the TCC's motion to dismiss the case as a bad-faith filing.[13] On direct appeal, though, the Third Circuit reversed and ordered dismissal, in a panel opinion authored by Judge Ambro, and the full court unanimously denied LTL's motion for rehearing *en banc*.

THE LARGER STAKES FOR MASS-TORT LITIGATION GENERALLY

Before analyzing the formal doctrinal grounds on which the Third Circuit reversed the bankruptcy court, it is helpful to contextualize that decision within a complex and consequential set of larger systemic issues regarding how best (and in what forum) to resolve mass-tort obligations generally. The simplified version of the basic question, which engenders considerable controversy and debate, is this: Is the bankruptcy system or the nonbankruptcy tort system "better" at resolving mass torts?

The *LTL I* bankruptcy court explicitly "assess[ed] the merits of the competing judicial systems" as an integral part of its refusal to dismiss the case:

> In evaluating the legitimacy of Debtor's bankruptcy filing, this Court must also examine a far more significant issue: which judicial system—the state/federal court trial system, or a trust vehicle estab-

> lished under a chapter 11 reorganization plan structured and approved by the United States Bankruptcy Court—serves best the interests of this bankruptcy estate, comprised primarily of present and future tort claimants with serious financial and physical injuries.[14]

And the bankruptcy court's lengthy analysis and ultimate conclusion claiming a relative superiority for the bankruptcy system[15] undoubtedly influenced the way in which it interpreted and applied the Third Circuit's good-faith filing jurisprudence.

Judge Ambro's very respectful and tactful opinion does not directly address this aspect of the bankruptcy court's decision, but it certainly does not endorse the bankruptcy court's views. Moreover, and as we shall see, several aspects of the opinion seem to, at least implicitly, disavow those views. And, of course, it is indisputable that, at the end of the day, the Third Circuit was unconvinced that any comparison of the competing systems' relative merits could justify "J&J's ability to move thousands of claims out of trial courts and into bankruptcy court so they may be resolved, in J&J's words, 'equitably' and 'efficiently.' "[16]

The *LTL II* filing was propelled by precisely the same claim of purported bankruptcy superiority, and thus, the Third Circuit may be forced to more directly address whether that supposition is a legitimate basis for a Chapter 11 filing. I will have more to say about that in Part III of this series. First, though, let us consider what the Third Circuit said about that, even if only implicitly, in *LTL I*.

BANKRUPTCY IS ONLY APPROPRIATE AS A RESPONSE TO FINANCIAL DISTRESS

Whether a Chapter 11 filing is in response to the debtor's financial distress has always been a prominent feature of the good-faith filing doctrine. "Courts, therefore, have consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11."[17] To the extent it was at all unclear before, the unmistakable message of *LTL I* is that financial distress (or its absence) is *not* merely one factor among many in the case-by-case totality-of-circumstances inquiry that determines good (or bad) faith in filing for Chapter 11 relief. Rather, financial distress is an essential, necessary prerequisite for a Chapter 11 petition to be filed in good faith. Absence of financial distress, in and of itself, establishes bad faith.

"[T]he good-faith gateway asks whether the debtor faces the kinds of problems that justify Chapter 11 relief."[18] And Chapter 11 "was meant to 'deal[] with the reorganization of a financially distressed enterprise.' "[19] A petitioner experiencing no financial distress, therefore, "has no need to rehabilitate or reorganize, [and] its petition cannot serve the rehabilitative purpose for which Chapter 11 was designed."[20] "[A]bsent financial distress, there is no reason for Chapter 11 and no valid bankruptcy purpose."[21] Filing Chapter 11 without financial distress is, therefore, bad faith *per se*.

Given pre-existing Third Circuit precedent, *LTL I*'s emphatic reaffirmation that financial distress is an absolutely necessary component of a good-faith Chapter 11 filing would hardly be noteworthy were it not for the conventional wisdom (apparently mistaken) that financial distress is *not* required by the Fourth Circuit's good-faith filing jurisprudence (more on that in Part III of this series). The truly novel questions addressed in *LTL I*, therefore, concerned how to apply that financial-distress requirement to a Texas Two-Step filing.

ONLY THE FINANCIAL DISTRESS OF THE CHAPTER 11 PETITIONER CAN JUSTIFY A BANKRUPTCY FILING

The entire objective of the Texas Two-Step strategy is to ensure that Defendant's business operations are *not* subjected to the bankruptcy process. Thus, *only* BadCo files Chapter 11, and GoodCo remains outside bankruptcy. Nonetheless, in considering the existence of the financial distress that justifies a good-faith Chapter 11 filing, the *LTL I* bankruptcy court "consider[ed] the financial risks and burdens facing both [Defendant] Old JJCI *and* [BadCo] Debtor," LTL, the only entity that actually filed Chapter 11.[22] The Third Circuit, however, held that this was legal error requiring reversal:

> [T]he financial state of LTL—a North Carolina limited liability company formed under state law and existing separate from both its predecessor company (Old [JJCI]) and its newly incorporated

> counterpart company (New [JJCI])—should be tested independent of any other entity. That means we focus on its assets, liabilities, and, critically, the funding backstop it has in place to pay those liabilities.[23]

The bankruptcy court's only explanation for expanding the financial-distress inquiry to consider an entity that had *not* filed bankruptcy (and, indeed, that no longer existed) was that the divisional merger of Old JJCI "and the ensuing bankruptcy filing [of LTL] should be viewed by this Court as 'a single, pre-planned, integrated transaction' comprised of independent steps."[24] As the Third Circuit pointed out, though, the former simply does not follow from the latter: "It strains logic . . . to say the condition of a defunct entity should determine the availability of Chapter 11 to the only entity subject to it."[25]

Indeed, extending the financial-distress inquiry beyond the BadCo debtor is fundamentally inconsistent with the very essence of the divisional merger itself and the "single, pre-planned, integrated" Texas Two-Step stratagem—the entire purpose of which is to ensure that BadCo (and *only* BadCo) will be subject to the bankruptcy process. Pinpointing that central contradiction is one of the pivotal insights upon which Judge Ambro's masterful *LTL I* opinion is constructed:

> Even were we to agree that the full suite of reorganizational steps was a "single integrated transaction," this conclusion does not give us license to look past its effect: the creation of a new entity with a unique set of assets and liabilities, and the elimination of another. Only the former is in bankruptcy and subject to its good-faith requirement.
>
> . . . Put differently, as separateness is foundational to corporate law, which in turn is a predicate to bankruptcy law, it is not easily ignored. It is especially hard to ignore when J&J's pre-bankruptcy restructuring—ring-fencing talc liabilities in LTL and forming the basis for this filing—depended on courts honoring this principle.[26]

MASS-TORT LITIGATION, IN AND OF ITSELF, DOES NOT CONSTITUTE FINANCIAL DISTRESS

As I noted in my previous *Bankruptcy Law Letter* analysis of the Texas Two-Step, "one could easily read the [*LTL I* bankruptcy] court's opinion as saying that the magnitude of mass-tort litigation itself is all that matters—that sufficiently massive tort litigation *always* causes a defendant ' '*some*' degree of financial distress,' no matter the defendant or the defendant's resources."[27] That supposition is bolstered by the *LTL I* bankruptcy court's lengthy exegesis on why the bankruptcy system is purportedly superior to the tort system for resolving mass torts.[28] And the bankruptcy court's ultimate statement regarding the existence of sufficient financial distress supposedly legitimating the initial LTL bankruptcy filing was this:

> At the end of the day, this Court concludes that the weight of evidence supports a finding that J&J and Old JJCI were in fact facing a torrent of significant talc-related liabilities for years to come.[29]

Indeed, the bankruptcy court in another Texas Two-Step case, *Bestwall* (involving Georgia-Pacific's asbestos liability), quoted with approval by the *LTL I* bankruptcy court,[30] explicitly opined that "[t]he volume of current asbestos claims . . . as of the Petition Date, coupled with the projected number of claims to be filed through 2050 and beyond, is sufficient financial distress . . . to seek" bankruptcy relief in Chapter 11.[31]

The second blockbuster feature of the *LTL I* holding (with implications for *LTL II*, as discussed in Part III of this series) is that the Third Circuit flatly *rejects* that view, that sufficiently voluminous mass-tort litigation against a defendant (particularly if the defendant faces significant exposure to future claims), in and of itself, supplies sufficient financial distress for a good-faith bankruptcy filing:

> [Previous] cases show that mass tort liability can push a debtor to the brink. *But to measure the debtor's distance to it, **courts must always weigh** not just the scope of liabilities the debtor faces, but also **the capacity it has to meet them**.*[32]

Taking into account a putative debtor's ability to satisfy its obligations in determining the existence of sufficient financial distress for a good-faith Chapter 11 filing will, of course, prevent bankruptcy filings (whether via a Texas Two-Step or otherwise) to resolve the mass-tort liability of eminently solvent defendants, who face no "clear and present threat to entity viability and full payment of all claimants."[33]

As applied to a Texas Two-Step bankruptcy, though, it is the *combination* of the two foregoing, crucial elements of the *LTL I* holding that is particularly potent: (1) *only* the financial distress of the petitioning debtor can establish a good-faith filing, *and* (2) being the target of massive tort litigation, in and of itself, is *not* sufficient to establish the existence of financial distress. Those two precepts are particularly important in determining the good faith of a Texas Two-Step bankruptcy filing because *both* the resources *and* the potential distress of the BadCo debtor may well be very different than GoodCo's (or Defendant's, pre-divisional merger). And the *LTL I* Texas Two-Step provides a great illustration of that.

HOW A TEXAS TWO-STEP BADCO'S POTENTIAL FOR FINANCIAL DISTRESS CAN DIFFER FROM DEFENDANT'S OR GOODCO'S

As discussed above, the *LTL I* bankruptcy court seemed to be of the opinion that the immense scale of mass-tort litigation, in and of itself, *can* produce sufficient financial distress to justify resort to Chapter 11 relief. It is not at all surprising, then, that the court would, indeed, focus primarily (if not exclusively) upon the extent and expense of the talc litigation against Old JCCI, because

> Debtor [LTL] is the successor to Old JCCI and has been allocated its predecessor's talc-based liabilities . . . . One cannot distinguish between the financial burdens facing Old JCCI and Debtor [LTL]. At issue in this case is Old JJCI's talc liability (and the financial distress that liability caused), now the legal responsibility of Debtor [LTL].[34]

However, if (like the Third Circuit in *LTL I*) one (1) rejects the view that sufficiently massive tort liability can, in and of itself, constitute financial distress, and (2) insists that only financial distress of the entity that filed Chapter 11 can justify that filing, then focusing upon the available resources to meet those mass-tort obligations necessarily requires a differentiation between the various entities. As the Third Circuit stated: "Even were we unable to distinguish the financial burdens facing the two entities, we can distinguish their vastly different sets of available assets to address those burdens."[35]

The resources available to LTL and Old JJCI to pay talc obligations were "vastly different" because of the funding agreement, under which not only New JJCI, but *also J&J* had obligated itself to pay LTL's talc liabilities up to a floor amount of at least $61.5 billion.

> Most important, . . . the [funding agreement] gave LTL direct access to J&J's exceptionally strong balance sheet. At the time of LTL's filing, J&J had well over $400 billion in equity value with a AAA credit rating and $31 billion just in cash and marketable securities. It distributed over $13 billion to shareholders in each of 2020 and 2021. It is hard to imagine a scenario where J&J . . . would be unable to satisfy their . . . obligations under the Funding Agreement. And, of course, J&J's primary, contractual obligation to fund talc costs was one never owed to Old [JJCI] . . . .[36]

Indeed, the fact that J&J was also an obligor under the funding agreement essentially rendered New JJCI entirely irrelevant, along with any financial distress that New JJCI might encounter by virtue of its obligations under the funding agreement. As the Third Circuit noted:

> It may be that a draw under the Funding Agreement results in payments by New [JJCI] that in theory might someday threaten its ability to sustain its operational costs. But those risks do not affect LTL, for J&J remains its ultimate safeguard.[37]

Thus, while the *LTL I* bankruptcy court "acutely focused on how talc litigation affected *Old [JJCI]*," that court "did not consider the full value of LTL's [funding] backstop when judging its financial condition."[38] Indeed, consistent with the view (rejected by the Third Circuit) that massive litigation itself can produce sufficient financial distress, irrespective of the petitioning debtor's resources, "the Bankruptcy Court hardly considered the value of LTL's payment right[s]" under the funding agreement at all.[39] And the Third Circuit held that "[t]his misdirection was legal error."[40]

CONSIDERING BADCO'S ABILITY TO MEET ITS MASS-TORT OBLIGATIONS REQUIRES A CAREFUL ASSESSMENT OF THE REALISTIC EXTENT OF THOSE OBLIGATIONS

The Third Circuit, therefore, disagreed with the

Bankruptcy Court's assessment of the importance of "[t]he value and quality of [LTL']s assets" in determining the existence of the financial distress required for a good-faith bankruptcy filing, in particular, the Bankruptcy Court's underappreciation of LTL's "roughly $61.5 billion payment right against J&J."[41] But even beyond available assets, on the liability side of the equation the Third Circuit also took issue with "the casualness of the calculations supporting the [Bankruptcy] Court's projections" regarding the extent of LTL's monetary liability from the talc litigation, suggesting that those estimates were not "factual findings at all, but instead back-of-the-envelope forecasts of hypothetical worst-case scenarios."[42]

Of course, if one is simply screening for sufficiently substantial mass litigation that somehow justifies taking that litigation out of the "inferior" tort system so that it can be more "equitably" and "efficiently" resolved by the "superior" bankruptcy system, then back-of-the-envelope forecasts of hypothetical worst-case scenarios are likely all one needs to make that call. Because the Third Circuit *rejected* that view of what constitutes sufficient financial distress, though, a more searching inquiry of LTL's realistic liability was necessary, in order to determine LTL's realistic ability to satisfy those obligations.

In particular, the Third Circuit called out the canard characteristically invoked by those who contend that it is simply impractical (or impossible) to effectively or fairly resolve mass torts outside the bankruptcy system, to wit: (1) Take the number of pending (or pending and projected future) cases, (2) posit an estimated time and/or litigation costs of litigating an individual case through trial and to judgment and/or a notional judgment amount, and then (3) multiply (1) X (2). The product in step (3) is invariably a staggeringly large figure. But it is also an irrelevant straw man, because it is as true for mass-tort litigation as it is for civil litigation in general that *the vast majority of all filed claims are ultimately resolved* ***without*** *going to trial*, most frequently by settlement.[43] Recognizing that obvious truism, the Third Circuit held that the Bankruptcy Court's projections regarding LTL's talc liability, to the extent "they were factual findings" at all "were clearly erroneous,"[44] because "th[o]se projections ignore[d] . . . the possibility of meaningful settlement, as well as successful defense and dismissal, of claims by assuming most, if not all, would go to and succeed at trial."[45]

What's more, the bankruptcy "settlement" touted by its enthusiasts does not somehow magically erase the need to individually liquidate *each and every* tort claim for purposes of determining each and every claimant's distribution amount. In fact, liquidating each and every claim in the bankruptcy system must occur by the very same means as in the nonbankruptcy tort system: either (1) the parties settle on mutually agreeable terms, often facilitated by standard settlement matrices and various ADR mechanisms (established via a plan of reorganization[46] or a nonbankruptcy aggregate settlement mechanism[47]), or (2) the claimant litigates the case, which in the case of a personal injury claim includes the right to a jury trial, even when the resolution process is in the bankruptcy system.[48]

When it comes to resolving individual claims, then, the *only* meaningful difference between the bankruptcy aggregate settlement process and the available nonbankruptcy aggregate settlement processes is that bankruptcy provides defendant-debtors an opportunity (via various means) to *deny* claimants payment in full, even for so-called "full payment" plans of reorganization.[49] Embedded in the financial-distress requirement for a good-faith bankruptcy filing, then, is the eminently sound and just conviction that a defendant should *not* be able to deprive claimants of their right to payment in full via a bankruptcy filing unless the defendant is actually facing a "clear and present threat to entity viability and full payment of all claimants,"[50] the "problems that bankruptcy is designed to address."[51]

"To take a step back," the Third Circuit explained, "testing the nature and immediacy of a debtor's financial troubles, and examining its good faith more generally, are necessary because bankruptcy significantly disrupts creditors' existing claims against the debtor" and "can impose significant hardship on particular creditors," such that only "[w]hen *financially troubled* petitioners seek a chance to remain in business [is] the exercise of those powers . . . justified."[52] "[G]iven Chapter 11's ability to redefine fundamental rights of third parties, only those facing financial distress can call on bankruptcy's tools to do so."[53] "This safeguard ensures that claimants' pre-bankrutpcy remedies . . . are disrupted only when necessary."[54]

A BADCO SPECIFICALLY DESIGNED TO BE ABLE TO SEAMLESSLY PAY ALL CLAIMANTS IN FULL IS NOT IN FINANCIAL DISTRESS AT ITS INCEPTION

The Third Circuit in *LTL I* concluded that LTL simply did not realistically face any clear and present threat to entity viability or full payment of all claimants that would qualify as genuine financial distress that was "not only apparent, but . . . immediate enough to justify a filing."[55] In fact, it did not even present a close case.[56] The divisional merger was undoubtedly undertaken with an acute awareness of the risks that fraudulent conveyance law presented for that transaction,[57] which was obviously structured so that LTL would not be insolvent,[58] nor left with "an unreasonably small capital,"[59] ***nor*** would those who structured or approved the divisional merger intend or "believe[] that [LTL] would incur[] debts that would be beyond [LTL]'s ability to pay as such debts matured."[60]

Little wonder, then, that the evidence presented to the Bankruptcy Court *by LTL itself* made "clear that, on its filing, LTL did not have any likely need in the present or the near-term, or even in the long-term, to exhaust its funding rights to pay talc liabilities."[61] Thus, the Third Circuit concluded:

> From these facts—presented by J&J and LTL themselves—we can infer only that LTL, at the time of its filing, was highly solvent with access to cash to meet comfortably its liabilities as they came due for the foreseeable future. It looks correct [for LTL] to have [stat]ed, in a prior court filing, that there was not "*any imminent or even likely need of [it] to invoke the Funding Agreement to its maximum amount or anything close to it*." Indeed, the Funding Agreement itself recited that LTL, after the divisional merger and assumption of that Agreement, held "assets having a value at least equal to its liabilities and had financial capacity sufficient to satisfy its obligations as they become due in the ordinary course of business, including any [t]alc [r]elated [l]iabilities." This all comports with the theme LTL proclaimed in this case from day one: it can pay current and future talc claimants in full.
>
> We take J&J and LTL at their word and agree. LTL has a funding backstop, not unlike an ATM disguised as a contract, that it can draw on to pay liabilities without any disruption to its business or threat to its financial viability. . . .
>
> At base level, LTL, whose employees are all J&J employees, is essentially a shell company "formed," almost exclusively, "to manage and defend thousands of talc-related claims" while insulating at least the assets now in New[JCCI]. And LTL was well-funded to do this. As of the time of its filing, we cannot say there was any sign on the horizon it would be anything but successful in the enterprise. It is even more difficult to say it faced any "serious financial and/or managerial difficulties" calling for the need to reorganize during its short life outside of bankruptcy.[62]

THE ELEPHANT IN THE ROOM: A BAD-FAITH "LITIGATION TACTIC" BANKRUPTCY

The Third Circuit's reliance *solely* upon the lack of financial distress in ordering dismissal in *LTL I* has led many to believe that financial distress is the *only* relevant inquiry in determining whether a petitioner has filed Chapter 11 in good faith. Indeed, that seems to be the major premise upon which the *LTL II* filing is basing its (hotly contested) claim of good faith. That, however, is a misreading of both Third Circuit precedent and *LTL I*. As I pointed out in Part I of this series of articles, the Third Circuit's *BEPCO* decision[63] made clear that "[f]inancial distress is. . . *necessary* for a good-faith filing *but* ***not*** *sufficient*."[64] Likewise, *LTL I* confirms that the good-faith filing inquiry requires "testing the nature and immediacy of a debtor's financial troubles, ***and*** *examining its good faith more generally*."[65] "The takeaway here is that when financial distress *is* present, bankruptcy *may be* an appropriate forum for a debtor to address its mass tort liability,"[66] but "because LTL was *not* in financial distress, it *cannot* show its petition. . . was filed in good faith."[67]

Indeed, recall that the financial distress inquiry is simply part-and-parcel of the larger and ultimate good-faith question of "whether the petition serves a valid bankruptcy purpose."[68] Because the Bankruptcy Code in its entirety, and Chapter 11 in particular, "assumes a debtor in financial distress,"[69] the absence of financial distress is *per se* bad faith, i.e., *whatever* the petitioner's purposes are for filing Chapter 11, they simply cannot be valid bankruptcy purposes.

Notice, then, that the *per se* nature of the bad faith of a petitioner who is *not* experiencing financial distress means that the court need *not* identify what that petitioner's reasons for filing bankruptcy actually are, nor explain why those purposes are illegitimate. And that is precisely the way in which the *LTL I* opinion carefully limited its holding. Judge Ambro simply let the absence of financial distress do its work in establishing an irrebuttable presumption of bad faith: "Because LTL was not in financial distress, *it cannot show* its petition served *a valid bankruptcy purpose* and was filed in good faith."[70]

Narrowly relying upon the *per se* bad faith established by a lack of financial distress greatly simplifies the bad-faith determination. Of course, it can also obscure exactly what it is that is improper and illegitimate about the petitioner's resort to bankruptcy relief. It is not difficult, however, to identify the *illegitimate* purpose that was the impetus for the *LTL I* filing, which Judge Ambro himself strongly hinted at in a footnote:

> Because we conclude LTL's petition has no valid bankruptcy purpose, we need not ask whether it was filed "merely to obtain a tactical litigation advantage." Yet it is clear LTL's bankruptcy filing aimed to beat back talc litigation in trial courts. Still "[i]t is not bad faith to seek to gain an advantage from declaring bankruptcy—why else would one declare it?" While we ultimately leave the question unaddressed, a filing to change the forum of litigation where there is no financial distress raises, as it did in *SGL Carbon*, the specter of "abuse which must be guarded against to protect the integrity of the bankruptcy system."[71]

That unaddressed question likely cannot be left unanswered now, however, given the almost-instantaneous *LTL II* filing, which I will analyze in Part III of this series. Here, though, is the one-sentence executive summary: If the *LTL I* filing was a bad-faith "litigation tactic," which it most certainly was, then so too is the *LTL II* filing because, as LTL openly admits, its purposes and objectives in filing the second bankruptcy case are exactly the same as they were in the first case.

ENDNOTES:

[1]*In re* LTL Management, LLC, 64 F.4th 84 (3d Cir. 2023) [hereinafter *LTL I*].

[2]Ralph Brubaker, *Assessing the Legitimacy of the "Texas Two-Step" Mass-Tort Bankruptcy*, 42 Bankr. L. Letter No. 8, at 1 (Aug. 2022).

[3]The Texas Two-Step bankruptcy strategy is widely reputed to be the brainchild of Greg Gordon at Jones Day, https://www.jonesday.com/en/lawyers/g/gregory-gordon?tab=overview, who is debtor's counsel in all four of the pending Texas Two-Step cases. *See* Dan Levine & Mike Spector, *Going for Broke: How a Bankruptcy "Innovation" Halted Thousands of Lawsuits from Sick Plaintiffs*, Reuters Investigates (June 23, 2022, 2:59 PM GMT), https://www.reuters.com/investigates/special-report/bankruptcy-tactics-two-step/.

[4]See Tex. Bus. Orgs. Code § 1.002(55)(A) & tit. 1, ch. 10(A). The other states with divisional merger statutes are **Arizona**, Ariz. Rev. Stat. tit. 29, ch. 6; **Delaware**, Del. Code Ann. tit. 6, § 18-217(b)-(c); **Kansas**, Kan. Stat. Ann. § 17-7685a; and **Pennsylvania**, Pa. Cons. Stat. tit. 15, ch. 3(F).

[5]A similar, but slightly different permutation involving 3M's earplug liability has received a chilly reception from the bankruptcy court presiding over that case. *See In re* Aearo Technologies LLC, 642 B.R. 891 (Bankr. S.D. Ind. 2022); Brendan Pierson & Dietrich Knauth, *3M's Bid to Shield Itself from Earplug Lawsuits Faces Skeptical Judges*, Reuters (Apr. 5, 2023, 8:38 AM GMT), https://www.reuters.com/legal/3ms-bid-shield-itself-earplug-lawsuits-faces-skeptical-judges-2023-04-04/

[6]*In re* Bestwall LLC, 605 B.R. 43 (Bankr. W.D. N.C. 2019). The bankruptcy court certified that decision for direct appeal to the Fourth Circuit, but the Fourth Circuit declined to accept the direct appeal. *See In re* Bestwall LLC, Case No. 17-31795, Docket No. 987 (Bankr. W.D. N.C. Sept. 11, 2019), *petition denied*, No. 19-408, Docket No. 13 (4th Cir. Nov. 14, 2019). A motion for leave to appeal that (presumably interlocutory) decision is still pending in the district court. *See In re* Bestwall LLC, Civ. A. No. 19-396, Docket Nos. 2 & 3 (W.D. N.C. Aug. 12, 2019). Meanwhile, back in the bankruptcy court, the committee recently filed yet another motion to dismiss the case, on grounds of lack of subject-matter jurisdiction. *See In re* Bestwall LLC, Case No. 17-31795, Docket No. 2925 (Bankr. W.D. N.C. Mar. 30, 2023); Hayley Fowler, *Asbestos Claimants Take New Tack in Bestwall Dismissal Bid*, Law360 (Mar. 31, 2023, 7:28 PM EDT), https://www.law360.com/articles/1592508/.

[7]*See In re* DBMP LLC, 2021 WL 3552350, at *1 (Bankr. W.D. N.C. 2021).

[8]*See In re* Aldrich Pump LLC, 2021 WL 3729335, at *1 (Bankr. W.D. N.C. 2021).

[9]*See* Lisa Girion, *Powder Keg: Johnson & Johnson Knew for Decades That Asbestos Lurked in Its Baby Powder*, Reuters Investigates (Dec. 14, 2018, 2:00 PM GMT), https://www.reuters.com/investigates/special-report/johnsonandjohnson-cancer.

[10]*See* Ingham v. Johnson & Johnson, 608 S.W.3d 663, 680, 724, Prod. Liab. Rep. (CCH) P 20934 (Mo. Ct. App. E.D. 2020), cert. denied, 141 S. Ct. 2716, 210 L. Ed. 2d 879 (2021).

[11]*See* Annex 2 to Declaration of John K. Kim in Support of First Day Pleadings at 4-6, *In re* LTL Mgmt. LLC, Case No. 21-30589 (Bankr. W.D. N.C. Oct. 14, 2021) [hereinafter *LTL Funding Agreement*] (Section 2(a) and definitions of "JJCI Value" and "Permitted Funding Use"). The JJCI Value cap is also increased by the value of any member distributions that JJCI makes after the divisional merger.

[12]*See LTL Funding Agreement* at 4-5 (definition of "JJCI Value").

[13]*In re* LTL Management, LLC, 637 B.R. 396 (Bankr. D. N.J. 2022) [hereinafter *LTL I*].

[14]*Id*. at 406 & n.8.

[15]*See id*. at 410-16.

[16]*LTL I*, 64 F.4th at 110.

[17]*LTL I*, 64 F.4th at 101 (quoting *In re* Integrated Telecom Express, Inc., 384 F.3d 108, 122, 43 Bankr. Ct. Dec. (CRR) 175, Bankr. L. Rep. (CCH) P 80168 (3d Cir. 2004) (quoting *In re* SGL Carbon Corp., 200 F.3d 154, 166, 35 Bankr. Ct. Dec. (CRR) 116, 43 Collier Bankr. Cas. 2d (MB) 668, Bankr. L. Rep. (CCH) P 78084, 1999-2 Trade Cas. (CCH) ¶ 72739 (3d Cir. 1999))).

[18]*LTL I*, 64 F.4th at 102.

[19]*Id.* at 104 (quoting *SGL Carbon*, 200 F.3d at 166 (quoting S. Rep. No. 95-989, at 9, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5795)).

[20]*LTL I*, 64 F.4th at 101 (quoting *Integrated Telecom*, 384 F.3d at 122 (quoting *SGL Carbon*, 200 F.3d at 166))).

[21]*LTL I*, 64 F.4th at 101.

[22]*LTL I*, 637 B.R. at 407.

[23]*LTL I*, 64 F.4th at 105.

[24]*LTL I*, 637 B.R. at 407 (citation omitted).

[25]*LTL I*, 64 F.4th at 106.

[26]*Id.* at 105-06 (citations omitted). Moreover, *LTL I*'s insistence upon a debtor-only focus has potentially far-reaching implications for a whole range of controversial Chapter 11 issues, including (most obviously) nonconsensual nondebtor (or third-party) releases. *See* Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L.J.F. 960 (2022), https://ssrn.com/abstract=3960117; Adam Levitin, *The Implications of LTL's Per-Debtor Analysis*, Harvard Law School Bankruptcy Roundtable (Feb. 14, 2023), http://blogs.harvard.edu/bankruptcyroundtable/2023/02/14/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-postscript-and-analysis-of-third-circuit-dismissal-of-ltl-managements-bankruptcy/; Edward J. Janger & John Pottow, *Waltz Across Texas: The Texas Three-Step*, Harvard Law School Bankruptcy Roundtable (Feb. 14, 2023), http://blogs.harvard.edu/bankruptcyroundtable/2023/02/14/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-postscript-and-analysis-of-third-circuit-dismissal-of-ltl-managements-bankruptcy/.

[27]Brubaker, 42 Bankr. L. Letter No. 8, at 7 (quoting *LTL I*, 637 B.R. at 420 (emphasis added)).

[28]*See* Brubaker, 42 Bankr. L. Letter No. 8, at 7-8 (discussing those aspects of the *LTL I* bankruptcy court opinion).

[29]*LTL I*, 637 B.R. at 421.

[30]*Id.* at 408 & n.9.

[31]*Bestwall*, 605 B.R. at 49; *see LTL I*, 637 B.R. at 408 (quoting that same paragraph of the *Bestwall* opinion). And the *Bestwall* court reached that conclusion in spite of the fact that the court simultaneously found (in the very next paragraph) that "Bestwall has the full ability to meet all of its obligations (whatever they may be) through its assets and [Georgia-Pacific]'s assets, which are available through the Funding Agreement, and to continue as a going concern." *Bestwall*, 605 B.R. at 49 (record citation omitted).

[32]*LTL I*, 64 F.4th at 104 (emphasis added).

[33]Ralph Brubaker, *The Texas Two-Step and Mandatory Non-Opt-Out Settlement Powers*, Harvard Law School Bankruptcy Roundtable (July 12, 2022) [hereinafter Brubaker, *Texas Two-Step*], https://blogs.harvard.edu/bankruptcyroundtable/2022/07/12/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-the-texas-two-step-and-mandatory-non-opt-out-settlement-powers/. That is, unless the eminently solvent defendant (*not* experiencing any financial distress) can use the bankruptcy filing of a co-defendant (who *is* experiencing financial distress) to obtain a nonconsensual nondebtor (or third-party) "release" of its mass-tort liability. *See generally* Brubaker, 131 Yale L.J.F. at 981-92.

[34]*LTL I*, 637 B.R. at 417.

[35]*LTL I*, 64 F.4th at 105.

[36]*Id.* at 106.

[37]*Id.* at 109.

[38]*Id.* at 107 (emphasis in original).

[39]*Id.*

[40]*Id.*

[41]*Id.* at 106.

[42]*Id.* at 108.

[43]*See generally* Elizabeth Chamblee Burch, Mass Tort Deals: Backroom Bargaining in Multidistrict Litigation (2019); Alexandra Lahav, In Praise of Litigation 92-98 (2019); Abbe R. Gluck & Elizabeth Chamblee Burch, *MDL Revolution*, 96 N.Y.U. L. Rev. 1, 15-16 (2021).

[44]*LTL I*, 64 F.4th at 108.

[45]*Id.* at 107.

[46]*See* Brubaker, 131 Yale L.J.F. at 996.

[47]*See generally* Howard M. Erichson, *A Typology of Aggregate Settlements*, 80 Notre Dame L. Rev. 1769 (2005); Francis E. McGovern, *The What and Why of Claims Resolution Facilities*, 57 Stan. L. Rev. 1361 (2005).

[48]*See* 28 U.S.C.A. §§ 157(b)(5); 1411(a).

[49]*See* Brubaker, 42 Bankr. L. Letter No. 8, at 11-17.

[50]Brubaker, *Texas Two-Step*. *Accord LTL I*, 64 F.4th at 102 ("Financial distress must not only be *apparent*, but it must be *immediate* enough to justify a filing." (emphasis added)).

[51]Brubaker, *Texas Two-Step*.

[52]*LTL I*, 64 F.4th at 103 (quoting *Integrated Telecom*, 384 F.3d at 120 (emphasis added)).

[53]*LTL I*, 64 F.4th at 110.

[54]*Id.* at 111.

[55]*Id.* at 102.

[56]*See id.* at 110 (stating that "while it is unwise today to attempt a tidy definition of financial distress justifying in all cases resort to Chapter 11, we can confidently say the circumstances here fall outside those bounds"). *LTL I* detractors are prone to portray the decision as announcing a "new" and "unmanageable" financial distress requirement, neither of which are credible claims, as Judge Fitzgerald has quite sensibly observed. Hon. Judith K. Fitzgerald (ret.), *Over-Thinking Ramifications of the Dismissal of LTL Management LLC's Bankruptcy*, Harvard Law School Bankruptcy Roundtable (Feb. 14, 2023), https://blogs.harvard.edu/bankruptcyroundtable/2023/02/14/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-postscript-and-analysis-of-third-circuit-dismissal-of-ltl-managements-bankruptcy/.

[57]That risk also exposes individuals (including attorneys) who participate in the planning, structuring, approval, and execution of an actual-intent fraudulent transfer to potential civil and criminal liability, and for attorneys, potential professional discipline. *See generally* Thomas Moers Mayer, *Will the Lawyers Pay? Counsel's Ethical, Civil, and Criminal Exposure for Creating Asset Protection Trusts*, American Law Institute Continuing Legal Education Course Materials (May 4, 2015).

[58]*See, e.g.*, 11 U.S.C.A. § 548(a)(1)(B)(ii)(I). Uniform Voidable Transactions Act (UVTA) § 5(a); Uniform Fraudulent Transfer Act (UFTA) § 5(a); Uniform Fraudulent Conveyance Act (UFCA) § 4. Such insolvency not only satisfies the financial vulnerability requirement for a constructively fraudulent transfer, it is also a "badge of fraud" that supports an inference of "actual intent to hinder, delay or defraud" creditors. 11 U.S.C.A. § 548(a)(1)(A); UVTA/UFTA § 4(a)(1); UFCA § 7. *See* UVTA/UFTA § 4(b)(9).

[59]*Id.* § 548(a)(1)(B)(ii)(II); UVTA/UFTA § 4(a)(2)(i); UFCA § 5. That circumstance would satisfy the financial vulnerability requirement for a constructively fraudulent transfer and likely also provide evidence in support of an inference of "actual intent to hinder, delay, or defraud" creditors. 11 U.S.C.A. § 548(a)(1)(A); UVTA/UFTA § 4(a)(1); UFCA § 7. *See* UVTA/UFTA § 4(b)(9).

[60]*Id.* § 548(a)(1)(B)(ii)(III). *Accord* UVTA/UFTA § 4(a)(2)(ii); UFCA § 6. That circumstance would satisfy the financial vulnerability requirement for a constructively fraudulent transfer and also, presumably, strongly support an inference of "actual intent to hinder, delay, or defraud" creditors. 11 U.S.C.A. § 548(a)(1)(A); UVTA/UFTA § 4(a)(1); UFCA § 7.

[61]*LTL I*, 64 F.4th at 108.

[62]*Id.* at 108-09 (emphasis in original) (record citations omitted) (quoting *SGL Carbon*, 200 F.3d at 164).

[63]*In re* 15375 Memorial Corp. v. BEPCO, L.P., 589 F.3d 605, 52 Bankr. Ct. Dec. (CRR) 146, Bankr. L. Rep. (CCH) P 81652 (3d Cir. 2009)

[64]Brubaker, 42 Bankr. L. Letter No. 8, at 7 (emphasis added).

[65]*LTL I*, 64 F.4th at 103 (emphasis added).

[66]*Id.* at 104 (emphasis added).

[67]*Id.* at 110 (emphasis added).

[68]*Id.* at 100-01 (quoting *BEPCO*, 589 F.3d at 618 (quoting *Integrated Telecom*, 384 F.3d at 120)).

[69]*Integrated Telecom*, 384 F.3d at 128.

[70]*LTL I*, 64 F.4th at 110 (emphasis added).

[71]*Id.* at 110 n.19 (citations omitted) (quoting, respectively, *BEPCO*, 589 F.3d at 618; Matter of James Wilson Associates, 965 F.2d 160, 26 Collier Bankr. Cas. 2d (MB) 1673, Bankr. L. Rep. (CCH) P 74636 (7th Cir. 1992); and *SGL Carbon*, 200 F.3d at 169).

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Bankruptcy Law Letter

OCTOBER 2024 | VOLUME 44 | ISSUE 10

IN THIS ISSUE:

ASSESSING THE LEGITIMACY OF THE "TEXAS TWO-STEP" MASS-TORT BANKRUPTCY (PART III): THE CONSTITUTIONAL LIMITS OF THE BANKRUPTCY POWER

*By Ralph Brubaker**

INTRODUCTION

The controversial Texas Two-Step mass-tort bankruptcy strategy has encountered significant judicial resistance, with (1) the Third Circuit ordering dismissal of the first Chapter 11 case filed (in bad faith, the court held) by the Johnson & Johnson (J&J) entity, LTL Management, formed to succeed to all of the corporate talc liability,[1] and (2) the New Jersey bankruptcy court's dismissal of J&J's second attempt to resolve its talc liability through another Chapter 11 case, filed almost instantaneously with the dismissal of the first case and *also* filed in bad faith, under the bad-faith filing standard announced by the Third Circuit, because its "emphasis on certainty and immediacy of financial distress closes the door of chapter 11 to LTL."[2]

J&J, however, is still pressing the Two-Step strategy and recently filed a *third* Two-Step case.[3] This time around, the new J&J subsidiary assigned the portion of the talc liability J&J is now seeking to resolve in bankruptcy (Red River Talc),[4] has fled the inhospitable Third Circuit and "Gone to Texas,"[5] filing in the Houston Division of the Southern District of Texas, and may (or may not) find a warmer reception there.

Meanwhile, however, there are a handful of Texas Two-Step cases that have been pending for many years in the Western District of North Carolina. Moreover, the bankruptcy courts in those cases have interpreted the Fourth Circuit's good-faith filing jurisprudence as *not* requiring *any* financial distress whatso-

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ever as a requisite of good faith, directly contrary to the Third Circuit's holding in *LTL Management*.[6] That interpretation of Code § 1112(b)—that the absence of financial distress, in and of itself, is *not* "cause" for dismissal of a Chapter 11 case—poses a fascinating constitutional issue: Is an eminently solvent, thriving, nondistressed debtor entity that poses no credible risk of nonpayment of creditors (that could threaten the viability of a business debtor) within the ambit of "the subject of Bankruptcies"[7] under the Bankruptcy Clause of the Constitution?

Recent decisions from two different North Carolina bankruptcy courts have addressed that constitutional issue—one in the *Bestwall* Texas Two-Step case,[8] filed to resolve the asbestos liability of Georgia-Pacific, and the other in the *Aldrich Pump* and *Murray Boiler* Texas Two-Step cases,[9] filed to resolve the Trane entities' asbestos liability. Each of those courts either found or assumed arguendo that the Two-Step debtor/s at issue were eminently solvent (in every imaginable sense of that word), *not* financially distressed, and fully "able to pay any conceivable liability" in the ordinary course, including all of their mass-tort liability, for "the foreseeable future (and the Debtor[s] d[id] not argue to the contrary)."[10] Nonetheless, both courts ultimately held that there is no constitutional limitation on the Bankruptcy Power that would compel dismissal of those debtors' bankruptcy cases. As discussed below, however, there is a contrary Ninth Circuit precedent, *In re Marshall* decided in 2013,[11] and the Fourth Circuit recently granted a direct appeal from the *Bestwall* decision (that is still pending) to consider the constitutional issue.[12]

This Part III, in my ongoing *Bankruptcy Law Letter* commentary on the Texas Two-Step mass-tort bankruptcy phenomenon,[13] explores this very intriguing constitutional issue. And unlike the bankruptcy courts in *Bestwall* and *Aldrich Pump & Murray Boiler*, I believe there are compelling reasons to conclude that the constitutional "subject of Bankruptcies" is indeed limited to debtors posing a risk of nonpayment of creditors (that threatens the viability of a business debtor).

A NONPAYING DEBTOR AS AN INTRINSIC DEFINITIONAL CHARACTERISTIC OF BANKRUPTCY

Article I, section 8, clause 4 of the Constitution authorizes Congress to establish uniform laws "on the subject of Bankruptcies." That exceedingly concise phrase is a window to a complex history both preceding and spawned by it. Even so, tracing that history from our English ancestry through our colonial beginnings, Independence, the Founding, and up until the present day, reveals a remarkable consistency at its core.

For purposes of attributing determinative legal meaning to "the subject of Bankruptcies," the Supreme Court has, from an early date, consistently "defined 'bankruptcy' as the 'subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief.' "[14] That elegant formulation has proven extremely durable and versatile. Its authorization of a collective distribution-and-discharge process in federal court has been used to repeatedly uphold ever more innovative and expansive legislative accommodations of the exigencies of financial embarrassment.

Even the broadest authorizations, however, contain limits, both explicit and implicit. And "the subject of Bankruptcies," as the Supreme Court's above-quoted conceptualization reveals, by its very nature connotes a debtor at risk of nonpayment of creditors, through either inability or unwillingness to pay. That inherent limitation on "Bankruptcies" is confirmed by examining the history of bankruptcy and insolvency legislation in England and in the American colonies and pre-Constitution states, as well as the original public meaning of the operative constitutional authorization for a federal "Bankruptcy" Power. And the Supreme Court has repeatedly recognized and stated that the essence of the "subject of Bankruptcies," as enshrined in the Constitution, is a collective process for distribution and discharge applicable to debtors posing a threat of nonpayment, attributable to either unwillingness or inability to pay creditors.

1. PRE-CONSTITUTION BANKRUPTCY AND INSOLVENCY LAWS

The formal English bankruptcy system at the time of American independence was limited to involuntary bankruptcy, brought by creditors against merchant "traders."[15] The bankrupt's property would be divided among the creditors, and the bankrupt could obtain a discharge from his debts if he "cooperated in the bankruptcy proceedings."[16] In addition, though, what were known as English "insolvency" laws had also provided a process, voluntarily initiated by imprisoned debtors (and *not* limited to merchants), to obtain their release by surrendering all of their nonexempt property for distribution among their creditors.[17]

The American colonies and pre-Constitution states adopted a "patchwork of insolvency and bankruptcy laws" that "were peculiar to the American experience," with "wildly divergent schemes for discharging debtors and their debts."[18] Nonetheless, as Professor Plank has correctly pointed out, the "English bankruptcy acts, the English insolvency acts, and the American statutes" all "had substantial similarities. They all provided for a collective proceeding between creditors" and their mutual debtor.[19] And for our present purposes, most "[s]ignificantly, all governed debtors who demonstrated an inability or, in the case of involuntary proceedings, an unwillingness to repay their creditors. *They did not apply to debtors who repaid their debts*."[20]

In the early involuntary versions of bankruptcy legislation, the all-important "acts of bankruptcy" (required for creditors' initiation of collective proceedings against a merchant debtor) were the means by which the law screened for a debtor who posed a threat of inability or unwillingness to repay creditors. "Each of these 'acts' involved the debtor doing something that would have caused any right thinking creditor to get concerned. The 'act,' therefore, raised a red flag,"[21] because "[a]n act of bankruptcy was a form of conduct that indicated that the debtor was attempting to prevent creditors from recovering on debts justly owed them."[22] Thus, with respect to the merchant debtors for whom the act-of-bankruptcy prerequisite was applicable, an "act of bankruptcy was . . . the law's attempt to identify failure" of the merchant's business.[23] And in that regard, "the law [wa]s extremely watchful to detect a man, whose circumstances are declining in the first instance, or at least as early as possible."[24]

2. THE ORIGINAL UNDERSTANDING OF THE CONSTITUTIONAL "SUBJECT OF BANKRUPTCIES"

In determining the meaning of "the subject of Bankruptcies," "[i]t is appropriate to presume that the Framers of the Constitution were familiar with the contemporary legal context when they adopted the Bankruptcy Clause."[25] Moreover, that presumed familiarity with the operation of extant bankruptcy and insolvency laws leads to the conclusion that the impetus for the Bankruptcy Clause, as recounted in detail by the Supreme Court in *Central Virginia Community College v. Katz*, was to provide for a uniform federal process, in lieu of "the uncoordinated actions of multiple sovereigns, each laying claim to the debtor's body and effects according to different rules," and with "a single discharge [to] protect the debtor from his jailer and his creditors."[26]

The Supreme Court is also "guided by the principle that '[t]he Constitution was written to be understood by the voters; its words and phrases were used in their normal and ordinary as distinguished from technical meaning.' "[27] And at the time of the Founding, "bankruptcy" was commonly understood to mean a legal process for, and more generally the situation confronting, one "who cannot pay his debts."[28] Indeed, examination of Framing-era dictionaries and other sources in order "to ascertain the ordinary acceptation of the term *bankruptcy* at the time when the constitution was adopted" readily indicates that its prevailing meaning was "any person's general inability to pay his debts."[29]

3. THE SUPREME COURT'S BANKRUPTCY POWER JURISPRUDENCE

Subsequent federal legislation under the Bankruptcy Clause, and the Supreme Court's interpretations of the meaning of that constitutional provision in adjudicating constitutional challenges to those statutes, confirm that the irreducible essentials of "the subject of Bankruptcies" are the simple, straightforward characteristics common to the cumulative English and early American legislation at the time of the Founding: a collective process of distribution and discharge for those evidencing a potential for unwillingness or inability to pay their debts, *i.e.*, bankrupts.

The first federal bankruptcy law, the Bankruptcy Act of 1800, provided an involuntary process initiated by creditors against a merchant, modeled upon existing English bankruptcy law.[30] The 1800 Act was short-lived, though, and the Supreme Court thereafter consistently concluded that the constitutional Bankruptcy Power is not limited by the idiosyncratic constraints that English law had placed upon its formal bankruptcy process—an involuntary process against only merchant debtors.

The constitutional "subject of Bankruptcies," therefore, also comprehends a *voluntary* process for *any* debtor presenting debt-repayment difficulties, as was available under both English and early American "insolvency" laws.[31] And the next federal bankruptcy law, the Bankruptcy Act of 1841, not only contained an involuntary process against merchant debtors, but also provided a voluntary process by which "*all* insolvent debtors could initiate proceedings to obtain a discharge of their existing debts."[32]

The breadth of the bankruptcy distribution and discharge power. An extremely influential opinion by Justice Catron (sitting as a Circuit Justice) upheld the constitutionality of the 1841 Act and, in doing so, set forth the definitive formulation, repeatedly and approvingly cited and quoted by the Supreme Court,[33] regarding the fullest sweep of the relief Congress can provide pursuant to its constitutional Bankruptcy Power:

> I hold it [the "subject of Bankruptcies"] extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of congress.[34]

With this extremely broad conception of the Bankruptcy Power, the Supreme Court has consistently upheld the constitutionality of progressively more expansive laws regarding the methods and means by which federal bankruptcy processes for distribution and discharge are conducted. "As the forms of available bankruptcy relief evolved over time" and "questions were raised as to whether the newer types of relief fell within the constitutional grant of power over the subject of bankruptcies," the "Supreme Court has regularly rejected these challenges."[35] Indeed, the Court has gone so far as to suggest that the permissible means of providing distribution and discharge relief to bankruptcy debtors and their creditors are infinite, and thus, "[t]he subject of bankruptcies is incapable of final definition."[36]

The nonpaying-debtor limit on the federal Bankruptcy Power. At the same time, though, *all* of the Supreme Court's jurisprudence regarding the breadth of the distribution and discharge power under the Bankruptcy Clause also fully acknowledges that "it does not follow that the power has no limitations."[37] Thus, "[o]n the 'subject of Bankruptcies,' the Court has uniformly upheld every law challenged on that basis, with the only requirement being that the law deal with the relations between a debtor and its creditors, *when the debtor is having difficulty paying its debts*."[38]

The bankruptcy courts in *Bestwall* and *Aldrich Pump & Murray Boiler* disregarded that aspect of the Supreme Court's jurisprudence and placed controlling emphasis on the Supreme Court's statements "that suggest that Congress's power *in this field* approaches omnipotence."[39] Even so, however, that simply begs the question: What is encompassed within "this field" and correlatively what is outside of "this field"?[40] Is a fully solvent entity, posing no credible threat of any nonpayment of creditors, properly regarded as within "this field" and thus a proper "subject of" a collective "bankruptcy" distribution and discharge process, or not?

Justice Blatchford pointed up the inevitability of that inescapable inquiry regarding the outermost boundaries of "the subject of Bankruptcies," as a prelude to his renowned description of the widely acknowledged, inherent nonpaying-debtor limit on Congress's collective distribution-and-discharge power. In his famous *Reiman* opinion, Justice Blatchford (then a district court judge) upheld the constitutionality of a statutory composition process for corporations (added to the Bankruptcy Act of 1867) that was an early precursor to the modern-day Chapter 11 reorganization process, and in doing so he stated:

> The power given must, indeed, be held to be general, unlimited and unrestricted over the subject. But the question recurs—what is the subject? The subject is "the subject of bankruptcies." What is "the subject of bankruptcies?" It is not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief.[41]

Likewise, Justice Story, the reputed author of the Bankruptcy Act of 1841, who was not known for warmly embracing limits on federal powers, nonetheless had also opined (in the 1851 edition of his constitutional law treatise) that a nonpaying debtor is an intrinsic feature of the constitutional "subject of Bankruptcies":

> Perhaps as satisfactory a description of a bankrupt law, as can be framed, is, that it is a law for the benefit and relief of creditors and their debtors, in cases, in which the latter are unable, or unwilling to pay their debts. And a law on the subject of bankruptcy, in the sense of the constitution, is a law making provisions for cases of persons failing to pay their debts.[42]

And even earlier, another influential statement of the nonpaying-debtor constraint on "the subject of Bankruptcies," was set forth by New York's Justice Cowen with the concurrence of Chief Justice (and later U.S. Supreme Court Justice) Nelson in *Kunzler v. Kohaus* (1843):

> Looking thus at the uniform popular acceptation of the word from the earliest times and in all English countries, and supposing that to be the true one, I read the constitution thus: "Congress shall have power to establish uniform laws on the subject of any person's general inability to pay his debts throughout the United States."[43]

All of the Supreme Court decisions that the *Bestwall* and *Adrich Pump & Murray Boiler* bankruptcy courts cited and discussed for the proposition "that Congress's power in this field approaches omnipotence,"[44] approvingly quote or cite Justice Blatchford's, Justices Story's, and/or

Justice Cowen's articulations of the intrinsic nonpaying-debtor limitation on "the subject of Bankruptcies."[45] Indeed, the Court has unwaveringly captured the essence of the constitutional subject of bankruptcies as "an omnibus proceeding between a nonpaying debtor on one side and the creditors on the other," in which "the debtor-creditor relation is to be readjusted or extinguished."[46] And as the Court has explained, those simple irreducible essentials of "the subject of Bankruptcies"—a collective distribution-and-discharge process for debtors hazarding debt-repayment difficulties—have been omnipresent before, during, and ever since the Founding:

> Throughout that evolutionary process, the court has hewn a straight path. Disclaiming a willingness to bind itself by a cramping definition, it has been able none the less to indicate with clearness the main lines of its approach. In substance, it agrees with Cowen, J., [in] *Kunzler v. Kohaus*, and with Blatchford, J., writing in the *Matter of Reiman*, that the subject of bankruptcy cannot properly be defined as "anything less than the subject of the relations between an insolvent or nonpaying * * * debtor, and his creditors, extending to his and their relief." Such was Story's view also. "A law on the subject of bankruptcies in the sense of the Constitution is a law making provision for persons failing to pay their debts."[47]

I fully concur, therefore, with Professor Plank's view "that the 'subject of Bankruptcies' has remained stable, even as the means of addressing the subject of bankruptcies have changed."[48] And a debtor at risk of nonpayment of creditors (that imperils the viability of a business debtor) has always been an integral definitional feature of "the subject of Bankruptcies."

THE NOVELTY OF THE CONSTITUTIONAL CHALLENGE

The bankruptcy courts in both *Bestwall* and *Aldrich Pump & Murray Boiler* reasoned that because there evidently are no decisions dismissing *on constitutional grounds* the case of a debtor posing no credible risk of nonpayment of creditors, then there must not be such a constitutional limitation.[49] That such a constitutional challenge has never before been made, however, cannot be the basis for summarily rejecting a challenge of apparent first impression, which is what those cases have presented. It is equally true that until those courts' decisions, there were evidently no decisions *refusing* to dismiss *on constitutional grounds* the case of a debtor posing no credible risk of nonpayment of creditors. The constitutional question of first impression was unavoidable (given those courts' construction of the Fourth Circuit's bad-faith filing jurisprudence), but those courts "decided" the issue without actually confronting it.

1. THE MARSHALL *DECISION'S RELIANCE UPON THE CONSTITUTIONAL NONPAYING-DEBTOR LIMITATION*

Even though the precise constitutional challenge at issue in the Texas Two-Step cases is evidently novel, the jurisprudential slate is not completely blank. A 21st-century decision, in the notorious *Marshall* bankruptcies saga,[50] addressed a similar (but different) constitutional challenge and, significantly, produced a Ninth Circuit precedent that explicitly relied upon the constitutional nonpaying-debtor standard.[51]

The constitutional argument in that case, in support of a motion to dismiss the debtors' bankruptcy case, was "that the Constitution . . . require[s] that a debtor in a bankruptcy case must be insolvent under a balance sheet test."[52] The bankruptcy court, however, held that the Bankruptcy Clause "does not require that a debtor in bankruptcy be insolvent."[53] Rather, the court looked to the nonpaying-debtor limitation repeatedly articulated by the Supreme Court and then refused to dismiss the debtors' Chapter 11 case because "[a]t the time of filing, it was not at all clear that the debtors could pay their creditors in full," and thus, "[t]he debtors in this case at least qualify as 'nonpaying' debtors, in the terminology of *Gibbons* [and many other Supreme Court decisions], and they certainly appeared to be failing when they filed their cases."[54]

Both the district court and the Ninth Circuit affirmed the bankruptcy court's decision and reasoning in published opinions. *All* of the *Marshall* opinions, therefore (including the precedential opinion of the Ninth Circuit), relied upon the Supreme Court's constitutional nonpaying-debtor limitation in deciding (and thus adopted it as the holding of) the case.[55]

2. THE "FINANCIAL DISTRESS" REQUIREMENT FOR A GOOD-FAITH FILING AS A RULE OF CONSTITUTIONAL AVOIDANCE

The rhetorical mystery posed by the bankruptcy courts in *Bestwall* and *Aldrich Pump & Murray Boiler*, asking why (if there is such a constitutional nonpaying-debtor limitation) there has never been such a constitutional challenge before, is really no mystery at all. Until enactment of the current Bankruptcy Code in 1978, *all* of the statutory reorganization provisions of prior law required that a reorganizing debtor be cash-flow insolvent.[56] The Bankruptcy Code eliminated any insolvency or other financial-distress requirement for a voluntary Chapter 11 filing *as a debtor-eligibility requirement*. Nonetheless, Code § 1112(b) expressly requires that a Chapter 11 case be dismissed "for cause," and all courts of appeals to address the issue have concluded that a Chapter 11 case filed in bad faith must be dismissed under that provision.[57]

What's more, and as the Third Circuit noted in its *LTL* decision ordering dismissal of the first J&J Texas Two-Step case, "financial distress is vital to good faith" required for a Chapter 11 filing,[58] and "debtors with no such need for relief . . . have found no favor with the Courts."[59] Consequently, and as the district court astutely observed in the *Marshall* case, "the requirements of good faith and financial distress are sufficient to assure that Court's [sic] need not reach the difficult constitutional question of drawing the exact boundary of the bankruptcy power" as regards the nonpaying-debtor requirement.[60] "At a minimum, then, the courts of appeals' good-faith filing jurisprudence that required dismissal of the *LTL*/J&J Texas Two-Step bankruptcies, because of the debtor's lack of any financial distress whatsoever, is a constitutional-avoidance jurisprudence."[61]

Hence, the *only* reason the constitutional issue arose in the *Bestwall* and *Aldrich Pump & Murray Boiler* cases is because of the bankruptcy courts' (admittedly dubious) interpretations of the Fourth Circuit's bad-faith filing jurisprudence. Their interpretation led those courts to incongruously conclude that "[t]he *absence* of financial distress ironically helps a debtor *avoid* a bad faith dismissal in th[e Fourth C]ircuit."[62] That interpretation, however, "would mean that the Fourth Circuit's good-faith filing doctrine . . . is unconstitutional," if the federal Bankruptcy Power requires (as I maintain) that a bankruptcy debtor must pose a credible risk of not paying its creditors.[63]

Curiously, though, the Fourth Circuit has accepted a direct appeal in *Bestwall* on *only* the novel constitutional issue and *not* the also-novel issue (in the Fourth Circuit) regarding applicability of the Fourth Circuit's bad-faith filing standard to an eminently solvent, nondistressed debtor. Both the constitutional-avoidance canon[64] *and* expeditious resolution of the pending Texas Two-Step cases[65] would seem to counsel resolving the uncertainty regarding the Fourth Circuit's bad-faith filing standard *before* entertaining difficult (and possibly hypothetical) constitutional questions.[66]

3. ADMINISTERING THE CONSTITUTIONAL NONPAYING-DEBTOR LIMITATION ON THE BANKRUPTCY POWER

The most perplexing aspect of the *Bestwall* bankruptcy court's opinion was its insistence that there can be no nonpaying-debtor limitation on the Bankruptcy Power unless the requirement is "definable."[67] That insistence on "precisely defin[ing] it,"[68] however, is flatly inconsistent with the Supreme Court's entire jurisprudence concerning the Bankruptcy Power. Indeed, the *Bestwall* bankruptcy court itself acknowledged (self-contradictingly) that "[t]he Supreme Court has resisted giving us a precise definition" of the

Bankruptcy Clause or the "*limits* to Congress's power pursuant to the Bankruptcy Clause."[69]

Instead, the Court has made clear that the constitutional contours of "the subject of Bankruptcies" must be determined according to the same method of constitutional adjudication that has prevailed ever since *Marbury v. Madison*—incrementally and cumulatively, over time, in the context of each individual "case or controversy" presenting a substantial constitutional question.[70] Indeed, the still-unresolved, full meaning and limits of "the subject of Bankruptcies," as applied to the Texas Two-Step innovation, nicely illustrates how that interpretive process is perpetually ongoing, as the Framers intended.[71] As the *Aldrich Pump & Murray Boiler* bankruptcy court acknowledged, "[o]bviously, using an artificially created subsidiary to obtain bankruptcy relief for a prosperous non-debtor corporate conglomerate is on the far reaches of the Congressional bankruptcy power, if within it at all."[72]

The *Bestwall* bankruptcy court claimed that such a state of affairs is unmanageable,[73] but there is no reason to believe that it is any more unmanageable than administering any other fact-intensive standards that bankruptcy courts routinely, competently, and efficiently address. For example, in the *Marshall* case, the bankruptcy court, the district court, and the Ninth Circuit all scrutinized the constitutional validity of the debtors' bankruptcy filing using the nonpaying-debtor standard and easily concluded, based on the facts of that case, that the debtors "qualif[ied] as 'nonpaying' debtors" because "[a]t the time of filing, it was not at all clear that the debtors could pay their creditors in full."[74]

As the *Bestwall* bankruptcy court itself acknowledged, that is true for virtually every bankruptcy case that is filed because "[p]otential debtors normally do not want . . . a bankruptcy filing unless they have no other options and they normally have other options until they are insolvent or very close to it."[75] Contrary to the claims of the *Bestwall* bankruptcy court, therefore, bankruptcy courts will not have to make difficult constitutional determinations "in all of the cases before the court, now and in the future."[76]

Conversely, in the *Bestwall* case it was likely very easy to conclude that Bestwall did *not* satisfy the nonpaying-debtor standard, given the bankruptcy court's explicit finding that Bestwall was "able to pay any conceivable liabilities now and in the foreseeable future (and [Bestwall] does not argue to the contrary)."[77] And such cases are extremely rare, as the *Aldrich Pump & Murray Boiler* bankruptcy court pointed out.[78] Even the *Bestwall* bankruptcy court acknowledged that unlike Bestwall, "very few debtors have access to the resources of Fortune 500 companies" such as Georgia-Pacific.[79] Indeed, the fact that "this unusual case"[80] was apparently the first ever to raise the constitutional issue belies the *Bestwall* bankruptcy court's predictions of administrative havoc.

In fact, the *Bestwall* bankruptcy court cogently explained why "this unusual case" raised a question of first impression on the constitutional challenge at issue. As the court noted, fully solvent, non-distressed businesses "normally do not want to subject themselves to" all of the quite substantial direct and indirect costs and burdens of a bankruptcy proceeding.[81] But of course, "Texas Two-Step cases like this one, where an existing company (Georgia-Pacific here) creates a separate entity like the Debtor [to file bankruptcy] in order to gain access to benefits available only in bankruptcy for itself, appear to be an exception to this rule."[82] Indeed, as I noted in my initial *BLL* analysis of the Texas Two-Step, "the attendant direct and indirect costs of" a Chapter 11 bankruptcy case "provides some measure of self-regulating control on 'litigation tactic' filings," but the "Texas Two-Step maneuver," by keeping the business operations out of bankruptcy and thus "reducing the costs from a bankruptcy filing also reduces their deterrence of 'litigation tactic' filings."[83]

The *Bestwall* bankruptcy court also reasoned that a constitutional nonpaying-debtor limitation creates a problematic "tension with the [statutory] goal of getting potential debtors to commence their cases early."[84] But a nonpaying-debtor requirement is no more inconsistent with that goal than is the "financial distress" requirement for a good-faith filing.[85] Indeed, because the "financial distress" standard is itself a rule of constitutional avoidance, the constitutional standard is perforce *no more* (and likely *even less*) demanding than the "financial distress" necessary for statutory good faith. And in any event, as the *Bestwall* bankruptcy court acknowledged, "the priorities of the Bankruptcy Code" do not constrain the Constitution.[86] The Constitution constrains application of the Code.

THE NONPAYING-DEBTOR REQUIREMENT AS A STRUCTURAL PROTECTION OF OTHER CONSTITUTIONAL RIGHTS AND LIMITATIONS

An additional constitutional consideration informing the appropriate limitations on the Bankruptcy Power, which is of utmost significance in Texas Two-Step cases, comes from the structural restrictions that other constitutional rights and protections impose upon the reach of the federal Bankruptcy Power. The Supreme Court has consistently recognized that federal bankruptcy legislation, and federal courts' implementation thereof, cannot contravene the constitutional constraints upon federal power imposed by, inter alia, Fifth Amendment due process, the Seventh Amendment right to a jury trial, and Article III's structural limitations on the jurisdictional powers of the federal courts.

Moreover, both individually and collectively, those constitutional guarantees reinforce how and why a nonpaying debtor is a constitutive characteristic of "the subject of Bankruptcies," vitally important to the integrity of the Constitution's structural framework—the intricate web of inseparably interconnected federal powers and limitations thereon, each of which elucidates the meaning and limits of others. In other words, "[t]he grants of the Constitution always are to be read in the light of the restrictions."[87]

As relevant to Texas Two-Step cases, in particular, the restrictions imposed by the Fifth and Seventh Amendments and by Article III vividly highlight the firm structural foundation for the Supreme Court's long line of decisions articulating the nonpaying-debtor limitation on the Bankruptcy Power. Those constitutional constraints also corroborate the views of scholars such as Professor Plank that a putative debtor posing no realistic threat of any nonpayment of creditors or consequent entity viability simply is not within the "subject of Bankruptcies" within the meaning of the Bankruptcy Clause, and that the federal courts have no Article III subject-matter jurisdiction to entertain a "bankruptcy" case concerning that putative debtor.

1. CLAIMANTS' DUE PROCESS OPT-OUT RIGHTS

The Supreme Court has made clear that an unsecured creditor's "cause of action is a species of property" that is "deserving of due process protections."[88] Moreover, "[t]he bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment" and its due process guarantee.[89] Thus, even though an inchoate tort claim is merely "an unsecured claim" comprised of "a cause of action against [a debtor's bankruptcy] estate," that "intangible interest is property . . . protected by the [Constitution]'s Due Process Clause[s]."[90] Consequently, "Congress . . . may authorize the bankruptcy court to affect those property rights, provided the limitations of the due process clause are observed."[91]

The due process right that directly abuts (and punctuates the structural function of the nonpaying-debtor limitation on) "the subject of Bankruptcies," is the due process opt-out right that the Supreme Court recognized in *Ortiz v. Fibreboard Corp.*[92] In that case, the lower courts had approved a mandatory no-opt-outs "settlement" of a defendant's aggregate mass-tort liability to both present and future asbestos claimants. The Supreme Court, however, held that such a mandatory no-opt-outs settlement of a defendant's aggregate mass-tort liability is an impermissible, unconstitutional violation of claimants' due process rights if the defendant's resources are sufficient to fully pay all of the claims.

"[A]t a minimum," then, due process requires that a claimant "must be provided with an opportunity to remove himself" from such an aggregate resolution process.[93] Indeed, for the kinds of damages claims of concern in Texas Two-Step cases, the Supreme Court has made it abundantly clear that the "absence of . . . opt out violates due process."[94] Fundamental to a claimant's due process rights, therefore, which recognize that an individual tort claimant has the property rights of an owner, is the claimant's autonomy and control over prosecution of the claim such that any "settlement" of that claim cannot be imposed without the claimant's consent.[95] There are extraordinary exceptions to that principle, but as the Supreme Court stated in *Ortiz*, "the burden of justification rests on the exception."[96]

Bankruptcy is a payment-insufficiency exception to due process opt-out rights. The *Ortiz* Court hypothesized that an exception *might* be appropriate, and thus taking away individual claimants' due process right to exclude themselves from such an aggregate resolution process (and pursue their claims on their own) *might* be justified, *if* the defendant's resources were insufficient to fully pay all claims ("otherwise some . . . would be paid and others . . . would not").[97]

"The concept driving" any such exception to claimants' due-process right of ownership and control over their individual claims would, therefore, be "its necessity," borne of a defendant's payment-resource "insufficiency, which alone [could] justif[y] the limit on an early feast to avoid a later famine."[98] But, of course, if the defendant "admit[s] assets sufficient to cover its debts, . . . no [such] prejudice . . . would result" from permitting individual claimants to opt out and pursue their claims separately.[99]

Significantly, though, the *Ortiz* Court cautioned that there may well be *no* such resource-insufficiency "limited fund" exception that would permit denying individual money-damages claimants their due process right to opt out of an aggregate settlement process and pursue their claims on their own. Indeed, the Court issued an explicit "warning of the serious concerns that come with *any* attempt to aggregate individual tort claims on a limited fund rationale" for purposes of imposing a mandatory no-opt-outs settlement on nonconsenting claimants.[100]

Why would there be no such exception? *Because that is what bankruptcy is for!* Permitting mandatory no-opt-outs settlement on the basis of a mass-tort defendant's inability to pay all claimants in full would be "the functional equivalent to bankruptcy."[101] As the *Aldrich Pump & Murray Boiler* bankruptcy court observed, "the binding distribution scheme effectuated by a confirmed plan of reorganization [in Chapter 11] is functionally identical to the mandatory non-opt-out settlement at issue in *Ortiz*."[102] Indeed, "the entire reason for and function of the bankruptcy process is to impose a mandatory no-opt-outs settlement process on all claimants," and bankruptcy's unique power to do so "resides in the constitutional discharge power."[103]

As the *Ortiz* Court emphasized, then, the Constitution itself provides for an extraordinary payment-insufficiency exception to tort claimants' otherwise-absolute due process opt-out rights, through the Bankruptcy Power.[104] If *any* mass-tort defendant, though, is a constitutionally eligible "bankruptcy" debtor, even "a prosperous . . . corporate conglomerate" that poses no credible threat to full payment of all claimants in the normal course of its ongoing, thriving business,[105] bankruptcy becomes nothing more than an end-run around claimants' due process opt-out rights. By limiting "the subject of Bankruptcies" to debtors presenting a realistic prospect for nonpayment of creditors (which threatens a business debtor's viability), the Constitution ensures that the Bankruptcy Power will not and cannot eviscerate claimants' fundamental due process rights.

Indeed, in dismissing a due process objection to confirmation of a precursor to the modern-day Chapter 11 plan of reorganization (and the corresponding discharge of the objector's claim), the Supreme Court emphasized that "the bankruptcy power may be exerted to give effect to a plan for the composition of debts of an *insolvent* debtor,"[106] because "the 'subject of bankruptcies' [i]s nothing less than 'the subject of the relations between an insolvent or nonpaying or fraudulent debtor, and his creditors, extending to his and their relief.' "[107] Congress "may authorize the bankruptcy court to affect [creditors' due-process] property rights" through a discharge of debt, but *only* "*if* Congress is acting within its bankruptcy power."[108]

The priority-preserving value of due process opt-out rights. As the Supreme Court recognized in *Ortiz*, claimants' due process right to opt out of an aggregate resolution process vindicates much more than just an abstract autonomy interest. It implicates the amount of money that tort victims can ultimately recover for their injuries and the equitable distribution of the value of a tort defendant's assets.

The ability to impose a mandatory no-opt-outs settlement on nonconsenting claimants (both present and future), whether via the limited-fund class action procedure at issue in *Ortiz* or through a Chapter 11 plan of reorganization, "enable[s] a mass-tort defendant to impose a judicially approved hard cap on their aggregate mass-tort liability."[109] The bankruptcy court in the *Aldrich Pump & Murray Boiler* case accurately perceived the substantial payment risks that such a capped payment trust imposes on tort claimants: "This arrangement places the risk that the trust fund will be depleted and insufficient to pay all claims and demands on the asbestos victims. The history of the nation's asbestos trusts has demonstrated this to be a real and considerable risk."[110]

The *Ortiz* Court held that such a capped repayment fund violates claimants' due process opt-out rights when the defendant can pay all claims in full, because it gives the defendant an "opportunity to benefit himself . . . by holding back on the amount distributed to" the tort claimants.[111] Indeed, the Court opined that residual equity holders' retention of any ownership interest is "irreconcilable with . . . denying any opportunity" for opt out by claimants "whose damages will be capped."[112] It gives "a defendant a better deal than seriatim litigation would have produced."[113]

That "better deal" is precisely what the Texas Two-Step is all about. "Bankruptcy's mass-tort Holy Grail is a mandatory no-opt-outs settlement of a defendant's aggregate mass-tort liability," which "enable[s] equity to capture value (and in some cases, potentially staggering amounts) at the expense of tort claimants."[114] The nonpaying-debtor limitation on the Bankruptcy Power, by protecting the integrity of claimants' due process opt-out rights, prevents mass-tort defendants from systematically short-changing tort claimants via a bankruptcy filing. And it ensures that bankruptcy's extraordinary payment-insufficiency exception to claimants' due process opt-out rights is reserved for cases in which "an insolvent or nonpaying or fraudulent debtor, and his creditors," actually need the bankruptcy process for "his and their relief."[115]

2. CLAIMANTS' SEVENTH AMENDMENT JURY TRIAL RIGHTS

Like the due process protection, the Seventh Amendment's guaranty of "the right of trial by jury" in "Suits at common law" also interacts with Congress's Bankruptcy Power in a manner that reinforces the structural importance of the nonpaying-debtor limitation on "the subject of Bankruptcies."

The Seventh Amendment constrains Congress's ability to deny parties their constitutional right to a jury trial in litigation conducted in federal court via federal bankruptcy jurisdiction.[116] Nonetheless, those with disputed legal claims, triable to a jury in the absence of a bankruptcy proceeding, will have *no* constitutional jury-trial right if their defendant files bankruptcy and those same claims are made against the defendant's bankruptcy estate. That is because,

> when the same issue arises as part of the process of allowance and disallowance of claims [against the estate], it is triable in equity. The Bankruptcy Act, passed pursuant to the power given to Congress by Art. I, § 8, of the Constitution to establish uniform laws on the subject of bankruptcy, converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*.[117]

Moreover, once a defendant files bankruptcy, plaintiffs with otherwise-legal damages claims against that defendant have no choice but to assert those claims against the now-debtor-defendant's bankruptcy estate (that has, by operation of law, succeeded to ownership of *all* of the debtor-defendant's property[118]), because they are enjoined from asserting their claims in any other forum.[119] Once a defendant files bankruptcy, plaintiffs "lack an alternative forum to the bankruptcy court in which to pursue their claims."[120]

The justification for forcing creditors into bankruptcy's mandatory no-opt-outs resolution process, in which they forfeit their constitutional jury-trial rights, breaks down if the putative debtor-defendant poses no credible threat to full payment of all creditors. As the Supreme Court explained in its most recent Seventh Amendment decision, creditors in bankruptcy have no constitutional jury trial rights because "bankruptcy claims" are "claims to a pro rata share of the bankruptcy res."[121] "[T]hose rights are necessarily limited in bankruptcy cases because of the limited pool of assets available to pay creditors."[122]

If the putative debtor poses no credible threat to full payment of all creditors, though, and thus no need to force creditors to share pro rata in a limited res, a bankruptcy filing improperly infringes creditors' Seventh Amendment rights, by artificially capping their recovery rights. Indeed, the Supreme Court so held in *Ortiz*. "By its nature, . . . a mandatory [no-opt-outs] settlement" process in such a case, "with legal issues and future claimants compromises their Seventh Amendment rights without their consent."[123] Claimants' "jury trial rights will be compromised" because their "damages will be capped."[124]

Most significantly, affording individual claimants an opportunity to try their claims against a payment trust by jury trial in a court, which is statutorily required in the case of personal injury and wrongful death tort claims against a debtor's bankruptcy estate,[125] does *not* cure the constitutional infirmity inherent in a mandatory no-opt-outs resolution process for a defendant-debtor who can fully pay all creditors *without* a mandatory aggregation process. Indeed, the *Ortiz* Court specifically refuted such a claim: "It is no answer . . . that the settlement provide[s] for a limited, back-end 'opt out' in the form of a right on the part of [claimants] eventually to take their case to a court if dissatisfied with the amount provided by the trust," if the settlement "limits damages" that can be recovered.[126] "The infringement of claimants' jury trial rights disapproved in *Ortiz* was placing a hard cap on a defendant's aggregate liability that is not determined by individual jury awards."[127]

As with claimants' due process opt-out rights, a nonpaying debtor is a necessary definitional feature of "the subject of Bankruptcies," in order to prevent a defendant posing no realistic threat to full payment of all creditors (that could also threaten the defendant's viability) from eviscerating claimants' Seventh Amendment jury-trial rights. As the *Aldrich Pump & Murray Boiler* bankruptcy court astutely recognized, "[w]here the debtor corporation is solvent and non-distressed, . . . there is no rational justification in such situations for impinging on the creditors' constitutional rights."[128]

3. ARTICLE III LIMITS ON FEDERAL COURTS' JURISDICTION

In both the *Bestwall* case and the *Aldrich*

Pump & Murray Boiler case, the asbestos claimants' committees argued that the nonpaying-debtor limitation on the Bankruptcy Power deprives the federal courts of jurisdiction to entertain bankruptcy proceedings concerning a debtor that poses no realistic risk of nonpayment of creditors and, thus the argument goes, that a bankruptcy case filed by such a debtor must be dismissed for lack of subject-matter jurisdiction. While the bankruptcy court in each case concluded that there is *no* such limitation on the Bankruptcy Power, those two courts disagreed regarding whether such a limitation (if it exists, as I maintain it does) is a constraint on the subject-matter jurisdiction of the federal courts. Sorting out that disagreement is important, because it reveals perhaps the most important dimension of the structural function of the intrinsic nonpaying-debtor feature of the constitutional "subject of Bankruptcies."

Case dismissal versus limiting bankruptcy relief. The bankruptcy court in the *Aldrich Pump & Murray Boiler* cases perceptively recognized the threat to individual claimants' due-process opt-out and Seventh Amendment jury-trial rights if a mass-tort defendant posing no risk of nonpayment of creditors is nonetheless permitted to force all mass-tort claimants into bankruptcy's mandatory no-opt-outs resolution process.

As that court reasoned, "a 'no-opt-out' bankruptcy plan and trust is entirely appropriate for an insolvent or even a distressed debtor," because in "these two situations, creditors risk not being paid."[129] "However, under *Ortiz* and for solvent and non-distressed debtors, a plan/trust which does not permit creditors to 'opt out' and return to the tort system for their jury trials may cause an unconstitutional impairment of the claimants' due process and jury trial rights."[130] Thus, if a "plan proposal contemplates a capped plan and a 'no[-]opt-out' trust" and the debtor is "neither. . . insolvent nor financially distressed, the question lies: is that plan constitutional?"[131]

The *Aldrich Pump & Murray Boiler* bankruptcy court, however, held that consideration of that question solely concerns the ultimate relief that such a debtor could constitutionally obtain and, thus, does *not* mandate *dismissal* of that debtor's bankruptcy case. And even if such a plan could not be constitutionally confirmed, theoretically at least, a constitutionally sound plan might nonetheless be confirmable:

> Potentially, a plan/trust might offer "evergreen" trust funding by the debtor and its allies to ensure all claims are paid in full. Or an 'opt out' right could preserve the right to litigate in the tort system [without restriction on the recoverable amount] for those claimants who prefer that course. Thus, even for a solvent and "non-distressed" . . . debtor and its creditors, there may be advantages to be obtained in Chapter 11.
>
> It may be, as the Movants argue, that these are "bad faith filings" subject to dismissal. If not, there may also be limits to the relief that Aldrich and Murray can constitutionally receive in these cases. However, the case filings themselves do not appear to be constitutionally infirm as being beyond the "subject of Bankruptcies."[132]

Note, then, that view of the interaction between the Bankruptcy Power, on the one hand, and individual claimants' due-process opt-out and Seventh Amendment jury trial rights, on the other, posits that the constitutional opt-out and jury-trial rights, at most, directly constrain only the constitutional *discharge* power as applied to non-distressed debtors. However, the other half of the great Bankruptcy Power—the *collective-distribution* feature of "the subject of Bankruptcies"—is *not* similarly constrained and, on that view, can function freely without regard to a defendant-debtor's impeccable prospects of fully and timely paying all creditors in the normal course without any resort to federal bankruptcy proceedings.

There is, of course, historical support for the view that the collective-distribution function of "bankruptcy" can be separated from the discharge function. Indeed, in the formal English bankruptcy process, a discharge of debt was not added to the collective-distribution process until 1705.[133] There is *no* historical support, however, for a collective-distribution "bankruptcy" process for debtors posing no threat of nonpayment of creditors. What's more, any attempt to divorce the collective-distribution function of "bankruptcy" from its intrinsic nonpaying-debtor attribute ignores the judicial federalism implications of *federal* bankruptcy proceedings under our Constitution and the limits that Article III places on the federal judicial power.

Even if *no* discharge of debt were available to a debtor without risk of nonpayment of creditors, invoking the federal Bankruptcy Power with respect to that debtor means conducting a collective-distribution "bankruptcy" process *in federal court*. Determining the constitutional propriety of such a putative "bankruptcy" process, thus, necessarily requires consideration of Article III's limitations on the federal judicial power.[134]

And if a proper interpretation of the relationship between Article III and the Article I Bankruptcy Power denies the federal courts any subject-matter jurisdiction over the proceedings, then it is utterly immaterial that the "debtor and its creditors" conclude that "there may be advantages to be obtained in Chapter 11" proceedings.[135] Litigants' mere (and even unanimous) desire to be in federal court does not (and cannot) give the court any subject-matter jurisdiction.[136]

The relationship between Article III and the Article I Bankruptcy Power. The *Bestwall* bankruptcy court agreed with the contention that "[t]he Bankruptcy Clause of the Constitution determines the limits of constitutional subject matter jurisdiction for bankruptcy."[137] And it is, indeed, the case that "[m]ost of the Supreme Court's discussions of Congress's constitutional power to vest bankruptcy jurisdiction in the federal courts simply rely upon Congress's [bankruptcy] power under Article I."[138] In fact, "in the entirety of our Anglo-American experience, bankruptcy has been conducted as a judicial process," and thus, "the Bankruptcy Clause of the Constitution, in authorizing Congress '[t]o establish . . . uniform Laws on the subject of Bankruptcies' was authorizing a *federal judicial* process."[139]

The federal judicial power in bankruptcy, therefore, is "co-extensive" with Congress's legislative power, as the Framers intended.[140] As Justice Story stated, in reference to the Bankruptcy Power and the constitutional limits on federal bankruptcy jurisdiction, "the judicial power has, in this respect, always been construed to be co-extensive with the legislative powers."[141]

At the same time, the constitutional design for the judicial function was that the states would, as before adoption of the Constitution, continue to be the only sovereigns with common law courts of general jurisdiction. The newly authorized federal courts, therefore, would have strictly limited subject-matter jurisdiction, *as constrained by Article III*, and the general authority of the state courts would thus be preserved against federal encroachment, by virtue of the Tenth Amendment's state-sovereignty bulwark: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively[.]"[142]

Consequently, Article III's limitations on the powers of the federal courts *also* circumscribe Congress in its grants of bankruptcy jurisdiction to the federal courts.[143] And Article III, like other general constitutional constraints on federal power, also interacts with the Bankruptcy Power to powerfully reinforce not only the structural function and importance of the nonpaying-debtor dimension of "the subject of Bankruptcies," but also why that limitation on the scope of the Bankruptcy Power is a subject-matter jurisdiction limitation. The constitutional limits of federal bankruptcy jurisdiction, therefore, are prescribed by a proper interpretation of "[t]he scope of the bankruptcy clause *in conjunction with* the judiciary article of the Constitution."[144]

The architectural feature of Article III that is most important in that regard is its foundational premise that Article III's limits on federal subject-matter jurisdiction would preserve "a protected sphere of state autonomy over the development and administration of state law."[145]

Thus, when each of the Texas Two-Step debtors filed bankruptcy, and in accordance with the constitutional design, thousands (and in some cases, tens of thousands) of state-law tort claims against the debtor entity and its affiliates were already pending in "state courts around the country."[146] Indeed, there would be *no* constitutional basis for *all* of those claims to have been brought in (or removed into) federal court. Yet, when the Two-Step designated-debtor entity filed bankruptcy, in each case a federal bankruptcy court *immediately* purported to assert federal jurisdiction over *all* of those state-law claims (and any more that might subsequently be filed) against *both* the debtor entity *and* nondebtor affiliates, not least for purposes of *immediately* staying their further assertion in any state court.[147]

Such a staggering enervation of state sovereignty is wholly justified (and indeed, a practical necessity) in cases of "an insolvent or nonpaying or fraudulent debtor," where a mandatory collective process in federal court is necessary for the relief of both the debtor "and his creditors."[148] In such a case, there is a sound constitutional and statutory basis for the assertion of federal jurisdiction over *all* of those state-law claims.[149]

In any case in which the debtor is able and would (were the case dismissed) continue to fully and timely pay all state-law tort claims in the normal course, without even a hiccup, there is no such justification for wholesale federal displacement of state-court jurisdiction over *all* state-law tort claims against both the debtor entity and its affiliates. The nonpaying-debtor limitation on the Bankruptcy Power is what properly preserves state sovereignty over state-law tort claims against an eminently solvent, nondistressed defendant, by properly confining the subject-matter jurisdiction of the federal courts within constitutional bounds.[150]

As the bankruptcy court in the *Aearo Technologies* case insightfully observed, in dismissing such a filing on statutory bad-faith grounds, "requiring . . . a debtor in need of bankruptcy relief protects this Court's jurisdictional integrity. Otherwise, a bankruptcy court risks becoming another court of general jurisdiction, which it most decidedly is not."[151] Likewise, as Professor Hazard pointed out, a "*constitutional* problem of a bankruptcy court's subject matter jurisdiction arises" if "the financial predicate for bankruptcy simply does not exist."[152]

A proper understanding of the structural relationship between Article III and the Article I Bankruptcy Power, therefore, vindicates Professor Plank's position that a debtor's constitutional eligibility for federal "bankruptcy" proceedings, because that debtor poses a risk of nonpayment of its debts (that threatens the viability of a business debtor), "is a jurisdictional requirement for invoking a bankruptcy proceeding."[153]

ARTICLE III LIMITS ON JURISDICTIONAL ENTITIES

The attempt by a Texas Two-Step debtor to create federal subject-matter jurisdiction over *all* state-law claims against it, exceeds the constitutional limits on the subject-matter jurisdiction of the federal courts in yet another way. A Texas Two-Step designated-debtor entity, by virtue of the divisional merger that creates it, and by its own admission, is an entity whose *sole* purpose is to create federal jurisdiction (that would otherwise be unconstitutional) over *all* state-law claims against it. Article III itself prohibits artificial manipulation of a putative bankrupt entity *solely* for the purpose of creating federal jurisdiction over all claims against that entity.

As the courts have recognized, "the essential purpose of the bankruptcy filing" by the designated-debtor entity in a Texas Two-Step case is to force "all the [tort] claims against it in[to] one forum" in federal bankruptcy court.[154] As discussed above, that exceeds the constitutional powers of the federal courts when the putative debtor entity poses no realistic threat of nonpayment of creditors (that could also threaten the viability of a business debtor) and, thus, is not a proper "bankruptcy" debtor, within the meaning of the Bankruptcy Clause. The Texas Two-Step maneuver, though, harbors another (independently) unconstitutional jurisdictional move, by ensuring that the *only* purpose of the bankruptcy filing is to force all claims against the debtor (including state-law claims for which there otherwise is *no* constitutional basis for federal jurisdiction) into a mandatory no-opt-outs aggregate resolution process in federal court.

As the courts have recognized, the divisional merger preceding a Texas Two-Step bankruptcy filing is "driven by" the mass-tort defendant's "desire to pursue its . . . business apart from [the mass tort] litigation or a bankruptcy proceeding while keeping its assets available," but outside of the federal bankruptcy process, "to satisfy any [mass tort] liabilities."[155] The "stated goal [i]s to isolate the [mass tort] liabilities in a new subsidiary so that entity could file for bankruptcy without subjecting [the rest of the] operating enterprise to bankruptcy proceedings."[156]

The divisional merger preceding a Texas Two-Step bankruptcy filing, therefore, ensures that the *only* purpose of the designated-debtor entity's bankruptcy filing is forcing "all the [mass tort] claims against it in[to] one forum" in federal bankruptcy court.[157] Chief Justice Marshall condemned such a jurisdictional device as violative of Article III in his seminal decision in *Osborn v. Bank of the United States*.[158]

Osborn's "original ingredient" (or federal entity) theory of constitutional federal-question jurisdiction is the basis on which a federal court can constitutionally entertain all state-law claims by and against a federal bankruptcy estate.[159] "The bankruptcy process," therefore, "instantly converts all of the state-law claims against a debtor-defendant into constitutional federal-question claims. That is because once a defendant files bankruptcy, those claims are now being asserted against a federally created entity—the now-debtor-defendant's federal bankruptcy estate."[160]

In the *Osborn* case, Justice Johnson, in dissent, objected to the constitutionality of federal jurisdiction founded simply on the basis of a federally created entity, as follows: "If this be true, why not make every citizen a corporation sole, and thus bring [any claim to which any citizen is a party] into the Courts of the United States *quo minus*?"[161] In response to Justice Johnson's critique, Chief Justice Marshall agreed that a jurisdiction-conferring entity, created for no other purpose than taking state-law claims (for which there would otherwise be no constitutional basis for federal jurisdiction) out of state court and putting them in federal court, would provide *no* basis for federal jurisdiction over state-law claims to which that entity is a party.[162]

The designated-debtor entity in a Texas Two-Step case is precisely such a sham jurisdictional entity, "formed on the eve of the bankruptcy filing, in order to isolate the mass-tort claims in that new entity, so that the *only* effect of the bankruptcy filing is to subject the mass-tort claims (and *only* the mass-tort claims) to the bankruptcy process in federal court, while all of the rest of the mass-tort defendant's business operations—assets, debts, litigation, etc.—remain completely outside the bankruptcy process."[163]

The Judicial Code explicitly provides that there is no federal jurisdiction over any case "in which [a] party . . . has been improperly . . . made . . . to invoke the jurisdiction of [the federal] court."[164] In addition, though, and as Professor Hazard observed, "there are *constitutional* limits to the legal fictions that may be employed to justify bankruptcy intervention."[165] And the Texas Two-Step, devised in order to create a jurisdictional entity whose sole purpose is to ship all of (and *only*) its mass-tort litigation into federal bankruptcy court, is beyond the constitutional pale.[166]

CONCLUSION

The Supreme Court has repeatedly articulated a nonpaying-debtor constraint in its standard formulation of the contours of the federal Bankruptcy Power. The wisdom of that limitation is revealed by examining the relationship and interaction between the Article I Bankruptcy Clause and other constitutional provisions, including both guaranties of fundamental individual rights and structural limitations on federal powers. For a mass-tort defendant that poses no realistic risk of nonpayment of creditors, the constitutive characteristic of a nonpaying debtor in bankruptcy protects individual tort claimants' rights (under both the Due Process Clauses and the Seventh Amendment) to remove themselves from an aggregate resolution process, by preventing the defendant from simply filing bankruptcy and thereby forcing those claimants nonetheless into bankruptcy's mandatory no-opt-outs aggregate resolution process, as Texas Two-Step debtors admittedly seek to do.

Moreover, the structural constitutional protection provided by a nonpaying-debtor constraint on the Bankruptcy Power limits the subject-matter jurisdiction of the federal courts. Otherwise, a mass-tort defendant, eminently able to fully and timely pay all of its creditors in the ordinary course (including all present and future mass-tort claimants) by the expedient of a bankruptcy filing could force into federal court all state-law claims against it, including thousands for which there otherwise would be *no* constitutional basis for federal jurisdiction. That is what Texas Two-Step debtors have also admittedly sought to do with their bankruptcy filings and, in the cases that have been pending in the Fourth Circuit for many years, have already succeeded in accomplishing.

ENDNOTES:

[1]*See* In re LTL Management, LLC, 64 F.4th 84 (3d Cir. 2023).

[2]In re LTL Management, LLC, 652 B.R. 433, 448-49 (Bankr. D. N.J. 2023), *aff'd*, 2024 WL 3540467 (3d Cir. 2024).

[3]*See* Adam Levitin, *If You're Gonna File in Texas, You Gotta Have Your Votes in Hand*, Credit Slips (Sept. 24, 2024) [hereinafter Levitin, *If You're Gonna File in Texas*], https://www.creditslips.org/creditslips/2024/09/if-youre-gonna-file-in-texas-you-gotta-have-your-votes-in-hand.html#more.

[4]As Professor Levitin explains, the *Red River Talc* case is only attempting to resolve domestic ovarian cancer claims and "gynecological" cancer claims, the latter of which he describes as " 'non-compensable' claims that have never been scientifically connected to talc" and, thus, appear to be attributable to "the phenomenon of stuffing the ballot box with 'junk' claims." *Id.; see also* Adam Levitin, *Stuffing the Chapter 11 Ballot Box with "Junk" Claims*, Credit Slips (Apr. 26, 2024), https://www.creditslips.org/creditslips/2024/04/stuffing-the-chapter-11-ballot-box-with-junk-claims.html#more.

[5]"Gone to Texas" was "often abbreviated 'GTT' on the doors of abandoned homesteads across the southeastern United States during the 1830s and 1840s." Randolph B. Campbell, Gone To Texas: A History of the Lone Star State ix (2003). The GTT phenomenon was attributable, at least in part, to "a slew of laws protecting debtors from creditors" in Texas and thus "a 'debtor-fugitive element' that was 'substantially greater than that of mature communities.' " Michael Ariens, Lone Star Law: A Legal History of Texas 18 (2011) (quoting Mark E. Nackman, *Anglo-American Migrants to the West: Men of Broken Fortunes? The Case of Texas, 1821-1846*, 5 W. Hist. Q. 441, 453 (1974)).

[6]*See In re* Aldrich Pump LLC, 2023 WL 9016506 at *22-*29 (Bankr. W.D. N.C. 2023); *In re* Bestwall LLC, 605 B.R. 43, 48-51 (Bankr. W.D. N.C. 2019).

[7]U.S. Const. art. I, § 8, cl. 4.

[8]*In re* Bestwall LLC, 658 B.R. 348 (Bankr. W.D. N.C. 2024).

[9]*Aldrich Pump*, 2023 WL 9016506 at *15-*22.

[10]*Bestwall*, 658 B.R. at 373; *see id.* at 363 n.14; *Aldrich Pump*, 2023 WL 9016506 at *14-*15.

[11]*In re* Marshall, 721 F.3d 1032, 58 Bankr. Ct. Dec. (CRR) 46 (9th Cir. 2013), *aff'g* 403 B.R. 668 (C.D. Cal. 2009), *aff'g* 300 B.R. 507 (Bankr. C.D. Cal. 2003).

[12]Order, Official Comm. of Asbestos Claimants of Bestwall LLC v. Bestwall LLC, No. 24-170 (4th Cir. May 31, 2024).

[13]*See* Ralph Brubaker, *Assessing the Legitimacy of the "Texas Two-Step" Mass-Tort Bankruptcy*, 42 Bankr. L. Letter No. 8 (Aug. 2022); Ralph Brubaker, *Assessing the Legitimacy of the "Texas Two-Step" Mass-Tort Bankruptcy (Part II)*, 43 Bankr. L. Letter No. 4 (Apr. 2023).

[14]Railway Labor Executives' Ass'n v. Gibbons, 455 U.S. 457, 466, 102 S. Ct. 1169, 71 L. Ed. 2d

335, 8 Bankr. Ct. Dec. (CRR) 966, 6 Collier Bankr. Cas. 2d (MB) 125, Bankr. L. Rep. (CCH) P 68557 (1982) (quoting Wright v. Union Central Life Ins. Co., 304 U.S. 502, 513-14, 58 S. Ct. 1025, 82 L. Ed. 1490 (1938)).

[15]*See* Charles Jordan Tabb, Law of Bankruptcy § 1.6 at 34-36 (5th ed. 2020) [hereinafter Tabb, Law of Bankruptcy].

[16]*Id.* at 36.

[17]*See* Ralph Brubaker, *Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Discharge as Statutory* Ex parte Young *Relief*, 76 Am. Bankr. L.J. 461, 505-06 (2002); John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 Am. Bankr. L.J. 163, 177-79 (1996); Thomas A. Plank, *The Constitutional Limits of Bankruptcy*, 63 Tenn. L. Rev. 487, 513-17 (1996).

[18]Central Virginia Community College v. Katz, 546 U.S. 356,, 365-66, 126 S. Ct. 990, 163 L. Ed. 2d 945, 45 Bankr. Ct. Dec. (CRR) 254, 54 Collier Bankr. Cas. 2d (MB) 1233, Bankr. L. Rep. (CCH) P 80443 (2006). *See generally* Peter J. Coleman, Debtors and Creditors in America: Insolvency, Imprisonment for Debt and Bankruptcy [During the Period of] 1607-1900 (1974). As the quoted passage indicates, "the term 'discharge' historically had a dual meaning; it referred to both release of debts and release of the debtor from prison." *Katz*, 546 U.S. at 364. *See generally* Brubaker, 76 Am. Bankr. L.J. at 504-09, 511-13.

[19]Plank, 63 Tenn. L. Rev. at 526.

[20]*Id.* (emphasis added).

[21]Andrew J. Duncan, *From Dismemberment to Discharge: The Origins of Modern American Bankruptcy Law*, 100 Com. L.J. 191, 204 (1995).

[22]Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 Am. Bankr. Inst. L. Rev. 5, 8 (1995). *See also* Julian Hoppitt, Risk and Failure in English Business, 1700-1800, at 36 (1987) [hereinafter, Hoppitt, Risk and Failure] ("an act of bankruptcy . . . amounted to an unreasonable evasion of . . . creditors' just demands for repayment").

[23]Hoppitt, Risk and Failure, at 36.

[24]2 William Blackstone, Commentaries *474.

[25]*Katz*, 546 U.S. at 362.

[26]*Id.* at 366.

[27]District of Columbia v. Heller, 554 U.S. 570, 576,128 S. Ct. 2783, 171 L. Ed. 2d 637 (2008) (citations omitted) (quoting United States v. Sprague, 282 U.S. 716, 731, 51 S. Ct. 220, 75 L. Ed. 640, 71 A.L.R. 1381 (1931)).

[28]William Perry, The Royal Standard English Dictionary 51 (1777) (definitions of "bankrupt" and "bankruptcy").

[29]Kunzler v. Kohaus, 5 Hill 317, 319-20, 1843 WL 4340 (N.Y. B.T.A. 1843) (emphasis in original). *See generally* Plank, 63 Tenn. L. Rev. at 529-32.

[30]*See* Bruce H. Mann, Republic of Debtors: Bankruptcy in the Age of American Independence 223 (2002); Tabb, Law of Bankruptcy, § 1.6, at 35 (the 1800 Act "virtually copied existing English law").

[31]*See* Sturges v. Crowninshield, 17 U.S. 122, 194, 4 L. Ed. 529, 1819 WL 2136 (1819) (Marshall, C.J.); Continental Illinois Nat. Bank & Trust Co. of Chicago v. Chicago, R.I. & P. Ry. Co., 294 U.S. 648, 667–68, 55 S. Ct. 595, 79 L. Ed. 1110 (1935). As Justice Story stated in his constitutional law treatise, "[n]o distinction was ever practically, or even theoretically attempted to be made between bankruptcies and insolvencies," as "a historical review of the colonial and state legislation will abundantly show." Joseph Story, Commentaries on the Constitution of the United States § 543, at 390 (1833).

[32]Plank, 63 Tenn. L. Rev. at 538 (emphasis added). *See also* Tabb, 3 Am. Bankr. Inst. L. Rev. at 17; John C. McCoid, II, *The Origins of Voluntary Bankruptcy*, 5 Emory Bankr. Dev. J. 361, 361 (1988).

[33]*See, e.g.*, Nelson v. Carland, 42 U.S. 265, 1 How. 265, 277, 11 L. Ed. 126, 1843 WL 5988 (1843) (reprinting Justice Catron's entire *Klein* opinion as an appendix); Hanover Nat. Bank v. Moyses, 186 U.S. 181, 186, 22 S. Ct. 857, 46 L. Ed. 1113 (1902); *Continental Illinois*, 294 U.S. at 669; Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 588 n.18, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A.L.R. 1106 (1935); Ashton v. Cameron County Water Imp. Dist. No. 1, 298 U.S. 513, 536, 56 S. Ct. 892, 80 L. Ed. 1309 (1936); *Gibbons*, 455 U.S. at 466.

[34]*In re* Klein, 14 F. Cas. 716, 718 (C.C. D. Mo. 1843) (No. 7,865) (Catron, Circuit Justice).

[35]Tabb, 3 Am. Bankr. Inst. L. Rev. at 44.

[36]*Wright*, 304 U.S. at 513.

[37]*Continental Illinois*, 294 U.S. at 669.

[38]Charles J. Tabb, *The Bankruptcy Clause, The Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. Ill. L. Rev. 765, 767 (emphasis added). Of course, the Court has also occasionally invoked the Bankruptcy Clause's textual reference to "uniform Laws" as a limiting the federal Bankruptcy Power, most recently in *Siegel v. Fitzgerald*, 596

U.S. 464, 142 S. Ct. 1770, 213 L. Ed. 2d 39, 71 Bankr. Ct. Dec. (CRR) 155, Bankr. L. Rep. (CCH) P 83753 (2022). *See* Troy A. McKenzie, *Uniformity Puzzles: A Comment on* Siegel v. Fitzgerald, 42 Bankr. L. Letter No. 5 (May 2022). The only intended function of the textual uniformity reference, however, was most likely to overcome the personal jurisdiction limitations on state-court bankruptcy and insolvency proceedings, by authorizing nationwide service of process "throughout the United States" in federal bankruptcy proceedings. *See* Ralph Brubaker, *Explaining* Katz*'s New Bankruptcy Exception to State Sovereign Immunity: The Bankruptcy Power as a Federal Forum Power*, 15 Am. Bankr. Inst. L. Rev. 95, 127-29 (2007).

[39]*Bestwall*, 658 B.R. at 369 (emphasis added); *see Aldrich Pump*, 2023 WL 9016506 at *17-*18.

[40]*See* Plank, 63 Tenn. L. Rev. at 490-91 ("discretion *within* the subject of bankruptcies does not imply that Congress has complete discretion to define the *boundaries* of the 'subject of Bankruptcies' ").

[41]*In re* Reiman, 20 F. Cas. 490, 496 (S.D.N.Y. 1874) (No. 11,673), *aff'd*, 20 F. Cas. 500 (C.C. S.D.N.Y. 1875) (No. 11,675) (Hunt, Circuit Justice).

[42]3 Joseph Story, Commentaries on the Constitution of the United States § 1113, at 53 n.2 (1851).

[43]Kunzler v. Kohaus, 5 Hill 317, 321 (N.Y. 1843).

[44]*Bestwall*, 658 B.R. at 369.

[45]*See Moyses*, 186 U.S at 187 (citing *Reiman* and *Kunzler*); *Continental Illinois*, 294 U.S. at 669-70, 672-73 (quoting *Reiman* and *Kunzler*); *Radford*, 295 U.S. at 588 n.18 (quoting *Reiman*); *Ashton*, 298 U.S. at 536 (quoting *Reiman*, Story, and *Kunzler*); U.S. v. Bekins, 304 U.S. 27, 47, 58 S. Ct. 811, 82 L. Ed. 1137 (1938) (quoting *Reiman*); *Wright*, 304 U.S. at 513-14 (quoting *Reiman*); *Gibbons*, 455 U.S. at 466 (quoting *Wright* quoting *Reiman*); *Katz*, 546 U.S. at 371 (quoting *Wright* quoting *Reiman*); Siegel v. Fitzgerald, 596 U.S. 464, 473, 142 S. Ct. 1770, 213 L. Ed. 2d 39, 71 Bankr. Ct. Dec. (CRR) 155, Bankr. L. Rep. (CCH) P 83753 (2022) (quoting *Wright* quoting *Reiman*); Campbell v. Alleghany Corp., 75 F.2d 947, 952 (4th Cir. 1935) (quoting Story, citing *Reiman* and *Kunzler*, and holding that "[c]ertainly, the act here [providing for a corporate reorganization process] is for the relief of corporate debtors who are unable to pay and their creditors, and falls well within the purpose of the constitutional grant of power"). The *Bestwall* bankruptcy court was, therefore, simply incorrect (and many times over) in its assertion that "the Supreme Court's descriptions of the Bankruptcy Power do not . . . even directly address[] the question of whether" a nonpaying debtor is an intrinsic definitional characteristic of "the subject of Bankruptcies." 658 B.R. at 370.

The *Bestwall* bankruptcy court also quoted me for the proposition that the federal Bankruptcy Power is "practically unlimited." *Id.* at 369 (quoting Brubaker, 15 Am. Bankr. Inst. L. Rev. at 131). In the article quoted, however, I was *criticizing* conceptualization of the Bankruptcy Power as "practically unlimited," because such an interpretation will "undermine any intended checks against endless encroachments of the federal judicial power into a [constitutionally] protected sphere of state autonomy." *Id.* Moreover, I have since extended that critique to Texas Two-Step cases. *See* Ralph Brubaker, *Mass Torts, the Bankruptcy Power, and Constitutional Limits on Mandatory No-Opt-Outs Settlements*, 23 Fla. St. Univ. Bus. Rev. (forthcoming 2024) (manuscript at 16-17), https://ssrn.com/abstract=4892178.

The *Bestwall* and *Aldrich Pump & Murray Boiler* bankruptcy courts both relied upon *International Shoe Co. v. Pinkus*, 278 U.S. 261 (1929), but that case involved only a statutory conflict-preemption issue, *not* the scope of Congress's Bankruptcy Power.

[46]*Ashton*, 298 U.S. at 537.

[47]*Id.* at 536-37 (italics added; footnote and citations omitted).

[48]Plank, 63 Tenn. L. Rev. at 500.

[49]*See Bestwall*, 658 B.R. at 370-71; *Aldrich Pump*, 2023 WL 9016506 at *18.

[50]The bankruptcy case of the wife of J. Howard Marshall II produced two Supreme Court decisions. *See* Marshall v. Marshall, 547 U.S. 293, 126 S. Ct. 1735, 164 L. Ed. 2d 480, 46 Bankr. Ct. Dec. (CRR) 122, Bankr. L. Rep. (CCH) P 80505 (2006); Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011). The opinions discussed in the text concerned the bankruptcy case filed by J. Howard Marshall III (son of J. Howard Marshall II) and his wife.

[51]*See* In re Marshall, 300 B.R. 507 (Bankr. C.D. Cal. 2003), *aff'd*, 403 B.R. 668 (C.D. Cal. 2009), *aff'd*, 721 F.3d 1032, 58 Bankr. Ct. Dec. (CRR) 46 (9th Cir. 2013).

[52]*Marshall*, 300 B.R. at 510.

[53]*Id.* at 510.

[54]*Id.* at 522-23; *see Gibbons*, 455 U.S. at 466 (quoting *Wright* quoting *Reiman*, and also stating that "Congress' power under the Bankruptcy

Clause 'contemplate[s] an adjustment of a failing debtor's obligations' " (quoting Moyses, 186 U.S. at 186)).

[55]*See Marshall*, 300 B.R. at 515, 521 (quoting Story, and *Gibbons* quoting *Wright* quoting *Reiman*), *aff'd*, 403 B.R. at 687 ("This 'insolvent, nonpaying, or fraudulent debtor' formulation is a common thread throughout the Supreme Court's bankruptcy jurisprudence."), *aff'd*, 721 F.3d at 1045 ("we adopt the bankruptcy court's opinion on [the] constitutional claims").

[56]*See* Plank, 63 Tenn. L. Rev. at 546-47.

[57]*See Aldrich Pump*, 2023 WL 9016506 at *30 (citing circuit decisions).

[58]*LTL*, 64 F.4th at 103 & n.14 (citing in support of "the central role it plays in other courts' inquiries," inter alia, the Fourth Circuit's decision in *Carolin Corp. v. Miller*, 886 F.2d 693, 19 Bankr. Ct. Dec. (CRR) 1425, Bankr. L. Rep. (CCH) P 73071 (4th Cir. 1989)).

[59]*Aldrich Pump*, 2023 WL 9016506 at *17.

[60]*Marshall*, 403 B.R. at 689.

[61]Brubaker, 23 Fla. St. Univ. Bus. Rev. (SSRN manuscript at 18).

[62]*Bestwall*, 658 B.R. at 379 n.37 (emphasis added) (and suggesting that "[t]his case may provide a basis for the Fourth Circuit to reexamine its standard for good faith, at least in Texas Two-Step cases like this one"); *see also Aldrich Pump*, 2023 WL 9016506 at *26-*27 (also suggesting that the Fourth Circuit "reconsider applicability of the *Carolin* Two-Prong Test [for a bad-faith filing] in the case of a solvent, non-distressed Chapter 11 debtor" because "arguably, both *Carolin* prongs presuppose financial distress").

[63]Brubaker, 42 Bankr. L. Letter No. 8, at 10. The *Bestwall* bankruptcy court, therefore, misperceived the nature of the constitutional challenge, characterizing it as an argument "that Congress failed to include a necessary condition, financial distress, in its statutory grant of jurisdiction to the bankruptcy court." *Bestwall*, 658 B.R. at 364. The constitutional challenge, however, is *not* claiming that *anything* in the Bankruptcy Code or the bankruptcy jurisdiction provisions of the Judicial Code is unconstitutional per se. Rather, it is an *as-applied* challenge to the constitutionality of the court's interpretation of the Fourth Circuit's bad-faith filing jurisprudence, which the *Aldrich Pump & Murray Boiler* bankruptcy court correctly understood. *See Aldrich Pump*, 2023 WL 9016506 at *14 (properly characterizing the constitutional challenge as raising "[q]uestions as to the constitutionality of [the Bankruptcy Code] as applied to a particular debtor" and, thus, "a challenge to these companies' eligibility as debtors" (emphasis in original)).

[64]*See* Toghill v. Clarke, 877 F.3d 547, 556 (4th Cir. 2017) ("federal courts have the duty to avoid constitutional difficulties"); Ward v. Dixie Nat. Life Ins. Co., 595 F.3d 164, 177, 68 A.L.R.6th 709 (4th Cir. 2010)("[T]he doctrine of constitutional avoidance attempts to 'giv[e] effect to [legislative] intent not [to] subvert [ ] it,' since it is premised on the 'reasonable' notion that legislators 'd[o] not intend [an interpretation] which raises serious constitutional doubts.' " (quoting Clark v. Martinez, 543 U.S. 371, 382, 125 S. Ct. 716, 160 L. Ed. 2d 734 (2005) (revisions contained in 4th Cir. opinion)); *id.* ("we decline to interpret the statute in a manner that gratuitously raises grave constitutional questions" (quoting Mary Helen Coal Corp. v. Hudson, 235 F.3d 207, 214 (4th Cir. 2000))); Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 247 (2011) ("A statute should be interpreted in a way that avoids placing its constitutionality in doubt."). *See generally* Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. and Const. Trades Council, 485 U.S. 568, 575, 108 S. Ct. 1392, 99 L. Ed. 2d 645, 128 L.R.R.M. (BNA) 2001, 108 Lab. Cas. (CCH) P 10418 (1988).

[65]*See Aldrich Pump*, 2023 WL 9016506 at *32-*33 (explaining why no progress can be expected in pending Texas Two-Step cases without definitive resolution of that issue).

[66]Wearing my academic hat, though, I can hardly complain. As my friend Dean Troy McKenzie once quipped, while judges want answers, we academics just want questions. And since I have already published thoughts regarding the bad-faith filing question in the August 2022 and April 2023 issues of *Bankruptcy Law Letter*, I have eagerly embraced the opportunity to publish thoughts on the constitutional question in this issue, providing even more evidence that I live by the motto for academic success espoused by my late colleague Ron Rotunda: No thought goes unpublished!

[67]*Bestwall*, 658 B.R. at 373 ("The concept is so vague that the Committee does not attempt to precisely define it despite asking this court to determine it is implicitly required by the Bankruptcy Clause.").

[68]*Id.*

[69]*Id.* at 368 (emphasis added).

[70]*See Continental Illinois*, 294 U.S. at 669-70 (the Bankruptcy Power's "limitations have never been explicitly defined" because "the nature of this power and the extent of it can best be fixed by the gradual process of historical and judicial

'inclusion and exclusion.' " (quoting Davidson v. City of New Orleans, 96 U.S. 97, 104, 24 L. Ed. 616, 1877 WL 18471 (1877)).

[71]*See* The Federalist No. 37 (James Madison) ("All new laws, though penned with the greatest technical skill and passed on the fullest and most mature deliberation, are considered as more or less obscure and equivocal, until their meaning be liquidated and ascertained by a series of particular discussions and adjudications."). "That in a Constitution, so new, and so complicated, there should be occasional difficulties & differences in the practical expositions of it, can surprize no one." Letter from James Madison to M.L. Hurlbert (May 1830), in 9 The Writings of James Madison 372 (Gaillard Hunt ed. 1910).

[72]*Aldrich Pump*, 2023 WL 9016506 at *32. *See also* Melissa B. Jacoby, Unjust Debts: How Our Bankruptcy System Makes America More Unequal 222 (2024) ("such cases are at best tenuously connected to the bankruptcy clause of the U.S. Constitution").

[73]*See Bestwall*, 658 B.R. at 373-79.

[74]*Marshall*, 300 B.R. at 522, *aff'd*, 403 B.R. at 689 (agreeing that "[i]n this case, there is no substantial constitutional question"), *aff'd*, 721 F.3d at 1045 ("we adopt the bankruptcy court's opinion on [the] constitutional claims").

[75]*Bestwall*, 658 B.R. at 372.

[76]*Id.* 376.

[77]*Id.* at 373.

[78]"The vast majority of cases filed in the bankruptcy courts over the years have been by persons and corporations who are both insolvent and highly distressed." *Aldrich Pump*, 2023 WL 9016506 at *17.

[79]*Bestwall*, 658 B.R. at 376.

[80]*Id.*

[81]*Id.* at 372.

[82]*Id.* at 372 n.29.

[83]Brubaker, 42 Bankr. L. Letter No. 8, at 19 n.66.

[84]*Bestwall*, 658 B.R. at 376.

[85]*See LTL*, 64 F.3d at 102-03 (reconciling the "financial distress" requirement with the statutory goal of encouraging early filing).

[86]*Bestwall*, 658 B.R. at 376 n.35.

[87]Associated Press v. National Labor Relations Board, 301 U.S. 103, 136, 57 S. Ct. 650, 81 L. Ed. 953, 1 Media L. Rep. (BNA) 2689 (1937).

[88]Tulsa Professional Collection Services, Inc. v. Pope, 485 U.S. 478, 485, 108 S. Ct. 1340, 99 L. Ed. 2d 565 (1988) (quoting Logan v. Zimmerman Brush Co., 455 U.S. 422, 428, 102 S. Ct. 1148, 71 L. Ed. 2d 265, 28 Fair Empl. Prac. Cas. (BNA) 9, 28 Empl. Prac. Dec. (CCH) P 32433 (1982)).

[89]*Radford*, 295 U.S. at 863.

[90]*Pope*, 485 U.S. at 485.

[91]*Wright*, 304 U.S. at 518.

[92]Ortiz v. Fibreboard Corp., 527 U.S. 815, 119 S. Ct. 2295, 144 L. Ed. 2d 715, 43 Fed. R. Serv. 3d 691 (1999).

[93]*Id.* at 848 (quoting Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 812, 105 S. Ct. 2965, 86 L. Ed. 2d 628, 2 Fed. R. Serv. 3d 797 (1985)).

[94]Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 362-63, 131 S. Ct. 2541, 180 L. Ed. 2d 374, 112 Fair Empl. Prac. Cas. (BNA) 769, 94 Empl. Prac. Dec. (CCH) P 44193, 161 Lab. Cas. (CCH) P 35919, 78 Fed. R. Serv. 3d 1460 (2011); *see also* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 349, 131 S. Ct. 1740, 179 L. Ed. 2d 742, 161 Lab. Cas. (CCH) P 10368 (2011).

[95]*See* Martin v. Wilks, 490 U.S. 755, 761-62, 109 S. Ct. 2180, 104 L. Ed. 2d 835, 49 Fair Empl. Prac. Cas. (BNA) 1641, 50 Empl. Prac. Dec. (CCH) P 39052, 14 Fed. R. Serv. 3d 1 (1989) ("[A] voluntary settlement . . . cannot possibly 'settle,' voluntarily or otherwise, the conflicting claims of [those] who do not join in the agreement."); Local No. 93, Intern. Ass'n of Firefighters, AFL-CIO C.L.C. v. City of Cleveland, 478 U.S. 501, 529, 106 S. Ct. 3063, 92 L. Ed. 2d 405, 41 Fair Empl. Prac. Cas. (BNA) 139, 40 Empl. Prac. Dec. (CCH) P 36200 (1986) ("Of course, parties who choose to resolve litigation through settlement may not dispose of the claims of a third party . . . without that party's agreement.").

[96]*Ortiz*, 527 U.S. at 846.

[97]*Id.* at 837.

[98]*Id.* at 838-39.

[99]*Id.* at 837 n.17.

[100]*Id.* at 845 (emphasis added).

[101]*Id.* at 843 (quoting Henry Paul Monaghan, *Antisuit Injunctions and Preclusion Against Absent Nonresident Class Members*, 98 Colum. L. Rev. 1148, 1164 (1998)).

[102]*Aldrich Pump*, 2023 WL 9016506 at *20 (quoting Ralph Brubaker, *The Texas Two-Step and Mandatory Non-Opt-Out Settlement Powers*, Harv. L. Sch. Bankr. Roundtable (July 12, 2022) [hereinafter Brubaker, *Texas Two-Step*], https://bankruptcyroundtable.law.harvard.edu/2022/07/12/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-the-texas-two-step-and-mandatory-non-opt-out-settlement-powers/).

[103]Brubaker, 23 Fla. St. Univ. Bus. Rev. (SSRN manuscript at 14, 17).

[104]*See Ortiz*, 527 U.S. at 846 (quoting *Martin v. Wilks*, 490 U.S. at 762 n.2 (1989) ("bankruptcy . . . proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process")). *See also Radford*, 295 U.S. at 589 ("[t]he bankruptcy power . . . is subject to the Fifth Amendment" due process constraints, but "[u]nder the bankruptcy power Congress may discharge the debtor's personal obligation").

[105]*Aldrich Pump*, 2023 WL 9016506 at *30.

[106]*Bekins*, 304 U.S. at 54 (emphasis added). As required by the statute, the debtor's bankruptcy "petition alleged insolvency," and the "District Court approved the petition as filed in good faith." *Id*. at 46.

[107]*Id*. at 47 (quoting *Reiman*).

[108]*Wright*, 304 U.S. at 518 (emphasis added).

[109]*Aldrich Pump*, 2023 WL 9016506 at *20 (quoting Brubaker, *Texas Two-Step*, and citing Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L.J.F. 960, 997-98 (2022), and Brubaker, 42 Bankr. L. Letter No. 8, at 9-10).

[110]*Aldrich Pump*, 2023 WL 9016506 at *19 n.22; *see* Melissa B. Jacoby, *Sorting Bugs and Features of Mass Tort Bankruptcy*, 101 Tex. L. Rev. 1745, 1759 & n.94, 1768-69 (2023).

[111]*Ortiz*, 527 U.S. at 839.

[112]*Id.* at 859-60.

[113]*Id.* at 839.

[114]Brubaker, 23 Fla. St. Univ. Bus. Rev. (SSRN manuscript at 11 (footnote omitted)); *see* Brubaker, 42 Bankr. L. Letter No. 8 at 11-17 (discussing the many ways in which "equity captures value at the expense of mass-tort claimants in bankruptcy").

[115]*Reiman*, 20 F. Cas. 496-97.

[116]*See, e.g.*, Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26, 19 Bankr. Ct. Dec. (CRR) 493, 20 Collier Bankr. Cas. 2d (MB) 1216, Bankr. L. Rep. (CCH) P 72855, 18 Fed. R. Serv. 3d 435 (1989); Schoenthal v. Irving Trust Co., 287 U.S. 92, 53 S. Ct. 50, 77 L. Ed. 185 (1932).

[117]Katchen v. Landy, 382 U.S. 323, 336 (1966).

[118]*See* 11 U.S.C.A. § 541(a)(1).

[119]*See id.* §§ 362(a), 524(a)(1)-(2).

[120]*Granfinanciera*, 492 U.S. at 59 n.14; *see also Stern v. Marshall*, 564 U.S. at 493 (claimant "had nowhere else to go if he wished to recover from [debtor's bankruptcy] estate").

[121]Securities and Exchange Commission v. Jarkesy, 144 S. Ct. 2117, 2135, 219 L. Ed. 2d 650, Fed. Sec. L. Rep. (CCH) P 101886 (2024) (quoting *Granfinanciera*, 492 U.S. at 56).

[122]*Aldrich Pump*, 2023 WL 9016506 at *20.

[123]*Ortiz*, 527 U.S. at 846.

[124]*Id.* at 860.

[125]*See* 28 U.S.C.A. §§ 157(b)(5), 1411(a).

[126]*Ortiz*, 527 U.S. at 847 n.23.

[127]Brubaker, 23 Fla. St. Univ. Bus. Rev. (SSRN manuscript at 15).

[128]*Aldrich Pump*, 2023 WL 9016506 at *21; *see also* Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 Notre Dame L. Rev. 606, 607, 677 (2008) (the Bankruptcy Clause "compel[s] exceptions to constitutional rules, standards, norms, and values in order to accommodate the exigencies of financial distress").

[129]*Aldrich Pump*, 2023 WL 9016506 at *21 & n.25.

[130]*Id*. at *21.

[131]*Id.*

[132]*Id*. at *22.

[133]*See* Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 Am. Bankr. L.J. 325, 333-39 (1991).

[134]*Cf. Aldrich Pump*, 2023 WL 9016506 at *13 ("constitutional challenges which are not targeted at the scope of Article III are not challenges to the Court's subject matter jurisdiction").

[135]*Id.* at *22.

[136]It is axiomatic that parties cannot confer subject-matter jurisdiction on a federal court by consent or waiver. *See* Insurance Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee, 456 U.S. 694, 702, 102 S. Ct. 2099, 72 L. Ed. 2d 492 (1982); Industrial Addition Ass'n v. C.I.R., 323 U.S. 310, 65 S. Ct. 289, 89 L. Ed. 260 (1945).

[137]*Bestwall*, 658 B.R. at 362 (citing Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 Wm. & Mary L. Rev. 743, 807 (2000)).

[138]Brubaker, 41 Wm. & Mary L. Rev. at 807 & n.231 (collecting cases in omitted footnote).

[139]Brubaker, 15 Am. Bankr. Inst. L. Rev. at 127 (emphasis in original).

[140]See The Federalist No. 80 (Alexander Hamilton) ("If there are such things as political axioms, the propriety of the judicial power of a government being co-extensive with its legisla-

tive, may be ranked among the number."); Scott A. Rosenberg, Note, *The Theory of Protective Jurisdiction*, 57 N.Y.U. L. Rev. 933, 944 & n.62 (1982) (collecting many references by the Framers to the co-extensive nature of the legislative and judicial powers under the Constitution).

[141]Mitchell v. Great Works Mill. & Mfg. Co., 17 F. Cas. 496, 499, No. 9662 (C.C.D. Me. 1843) (No. 9,662) (Story, Circuit Justice).

[142]*See* Bender v. Williamsport Area School Dist., 475 U.S. 534, 541, 106 S. Ct. 1326, 89 L. Ed. 2d 501, 30 Ed. Law Rep. 1024 (1986) ("Federal courts are not courts of general jurisdiction; they have only the power that is authorized by Article III of the Constitution[.]").

[143]*See, e.g.,* Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011); Northern Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) P 68698 (1982).

[144]William E. Mussman & Stefan A. Riesenfeld, *Jurisdiction in Bankruptcy*, 13 L. & Contemp. Probs. 88, 89 (1948) (emphasis added).

[145]Brubaker, 41 Wm. & Mary L. Rev. at 810.

[146]*In re* Bestwall LLC, 71 F.4th 168, 180 (4th Cir. 2023).

[147]*See* 11 U.S.C.A § 362(a) (stay of all claims against debtor); *In re* Bestwall LLC, 606 B.R. 243 (Bankr. W.D. N.C. 2019) (stay of claims against nondebtors), *aff'd*, 2022 WL 67469 (W.D. N.C. 2022), *aff'd*, 71 F.4th 168, 180 (4th Cir. 2023); *In re* LTL Mgmt., LLC, 638 B.R. 291 (Bankr. D.N.J. 2022) (stay of claims against nondebtors). And that stay of litigation, in and of itself, is incredibly valuable to a mass-tort defendant and, correlatively, prejudicial to the tort claimants. *See* Levitin, *If You're Gonna File in Texas* (describing the "delay to underpay" strategy); *Aldrich Pump*, 2023 WL 9016506 at *10 & n.13 (noting that "for the past three years, Debtors and the Affiliates have enjoyed a respite from the tort system and a 'payment holiday' from the $100 million-a-year costs they were previously incurring . . . . If anyone is being prejudiced, it is the claimants.").

[148]*Reiman*, 20 F. Cas. 496-97; *see* The Federalist No. 42 (James Madison) (stating that the federal Bankruptcy Power is such an obvious necessity "where the parties or their property may lie or be removed into different states that the expediency of it seems not likely to be drawn into question").

[149]The *constitutional* basis for federal jurisdiction lies in a combination of (1) federal-question jurisdiction, under the "original ingredient" (or federal-entity) theory of constitutional federal questions, and (2) constitutional supplemental jurisdiction, both of which were first articulated in Chief Justice Marshall's venerable opinion in *Osborn v. Bank of U.S.*, 22 U.S. 738, 6 L. Ed. 204, 1824 WL 2682 (1824). *See generally* Ralph Brubaker, *One Hundred Years of Federal Bankruptcy Law and Still Clinging to an* In Rem *Model of Bankruptcy Jurisdiction*, 15 Emory Bankr. Dev. J. 261 (1999). The *statutory* basis for federal jurisdiction is provided by the grant of federal jurisdiction over "all civil proceedings . . . arising in or related to" a bankruptcy case. 28 U.S.C.A. § 1334(b).

[150]The *Bestwall* bankruptcy court expressed, at length, concerns regarding whether a debtor's satisfaction of a constitutional nonpaying-debtor requirement "should be determined at the outset of a case or throughout the proceedings" and was especially troubled by the prospect of the latter, which the court suggested is "more consistent with a constitutional jurisdiction requirement." *Bestwall*, 658 B.R. at 375. It is axiomatic, however, that a federal court's subject-matter jurisdiction "is assessed at the time an action is filed," and "if jurisdiction exists at the time an action is commenced, such jurisdiction may not be divested by subsequent events." Freeport-McMoRan, Inc. v. K N Energy, Inc., 498 U.S. 426, 428, 111 S. Ct. 858, 112 L. Ed. 2d 951, 18 Fed. R. Serv. 3d 801 (1991). The *Bestwall* Bankruptcy Court's concerns, therefore, were unfounded.

[151]*In re* Aearo Technologies LLC, 2023 WL 3938436, at *21 (Bankr. S.D. Ind. 2023).

[152]Geoffrey C. Hazard, Jr., *The Futures Problem,* 148 U. Pa. L. Rev. 1901, 1909-10 (2000) (emphasis added).

[153]Plank, 63 Tenn. L. Rev. at 492.

[154]*Bestwall*, 71 F.4th at 176.

[155]*Id.* at 183.

[156]*LTL*, 64 F.4th at 93.

[157]*Bestwall*, 71 F.4th at 176.

[158]Osborn v. Bank of U.S., 22 U.S. 738, 6 L. Ed. 204, 1824 WL 2682 (1824).

[159]Indeed, the Supreme Court has confirmed that the constitutional basis for a bankruptcy estate's state-law suit in federal court is "exactly the same as that of the Bank of the United States," pursuing "a right arising under a law of the United States," within the meaning of Article III, § 2, cl. 1. Claflin v. Houseman, 93 U.S. 130, 135, 23 L. Ed. 833, 1876 WL 19239 (1876). *See generally* Brubaker, 15 Emory Bankr. Dev. J. at

282-83.

[160]Brubaker, 23 Fla. St. Univ. Bus. Rev. (SSRN manuscript at 16).

[161]*Osborn*, 22 U.S. (9 Wheat.) at 898 (Johnson, J., dissenting). The notorious English writ of *quo minus* was used to invoke the jurisdiction of the Court of Exchequer. That court was established as a court of limited jurisdiction, dealing with royal revenues, but the court transformed itself into essentially a court of general jurisdiction by indulging the pleading of a transparent legal fiction in the *quo minus*. *See generally* Harold Wurzel, *The Origin and Development of Quo Minus*, 49 Yale L.J. 39 (1939); Oliver R. Mitchell, *The Fictions of the Law: Have They Proved Useful or Detrimental to Its Growth*, 7 Harv. L. Rev. 249, 250-51 (1893).

[162]*See Osborn*, 22 U.S. (9 Wheat.) at 827 (Marshall, C.J.).

[163]Brubaker, 23 Fla. St. Univ. Bus. Rev. (SSRN manuscript at 16-17). Some of the Texas Two-Step debtors were allocated ownership of a small operating subsidiary in the divisional merger transaction that created the designated-debtor entity (BadCo). The only aspect of that subsidiary's business, though, that is property of BadCo's bankruptcy estate (and thus subject to the jurisdiction and control of the federal bankruptcy court) is BadCo's ownership interest in that subsidiary. The assets, debts, business operations, etc. of that subsidiary remain completely outside of the bankruptcy process, every bit as much as the assets, debts, business operations, etc. of the mass-tort defendant allocated to the other entity created by the divisional merger (GoodCo) that does *not* file bankruptcy. Only the *value* of GoodCo (via a funding agreement) and BadCo's subsidiary (via BadCo's ownership interest) are potentially available to satisfy tort claims against BadCo in the bankruptcy proceedings, in much the same way that a litigation defendant's assets remain beyond the jurisdiction and control of a trial court, unless and until a money judgment is entered against that defendant. BadCo's ownership of an operating subsidiary, therefore, does not change the fact that the *only* function of the Texas Two-Step bankruptcy case is to take all of the tort litigation out of the various courts (many of which are state courts) that would otherwise entertain that litigation, and force it all into the federal bankruptcy court.

[164]28 U.S.C.A. § 1359.

[165]Hazard, 148 U. Pa. L. Rev. at 1909 (emphasis added).

[166]*Cf. LTL*, 64 F.4th at 110 ("dismiss[ing] the bankruptcy filing of a company created to file for bankruptcy . . . restricts J&J's ability to move thousands of claims out of trial courts and into bankruptcy court").

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