Third Circuit Dismisses Chapter 11 Filing by Johnson & Johnson Subsidiary Formed to Segregate Talc Liabilities

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In a closely watched decision, the Court of Appeals for the Third Circuit ordered the dismissal of the Chapter 11 petition of LTL Management, LLC, the entity created by Johnson & Johnson to hold J&J's talc-related liabilities in a divisional merger process under Texas law.

Reversing the Bankruptcy Court for the District of New Jersey, the Third Circuit held that LTL's petition failed to meet the standards for a good-faith bankruptcy filing because the entity was not in financial distress. The court found that LTL had access to at least $61.5 billion in value under a funding agreement with J&J and another J&J unit, which was enough to cover currently projected talc liabilities. The court noted that the financial distress inquiry must focus on the debtor alone, and could not take into consideration the potential effect of a draw on the funding agreement on other J&J entities.

The immediate effect of the decision is to derail J&J's efforts to set up a trust to administer tens of thousands of talc-related injury claims, and to return those claims to the tort system. Although the Third Circuit did not rule that the strategy of using the Texas divisional merger statute to create a separate entity to hold liabilities, and then putting that entity into bankruptcy (sometimes known as the "Texas Two-Step") was inherently impermissible, the decision calls into question the ability of mass tort defendants to isolate those liabilities from their ongoing business operations and administer the tort claims in a separate bankruptcy.