The Business, Entrepreneurship & Tax Law Review

Volume 6 | Issue 2 Article 6

2022

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ABSTRACT

Corporate reorganization, also known as Chapter 11 of the Bankruptcy Code ("the Code"), operates under the premise that, in certain circumstances, an insolvent business entity is better equipped to repay its debts if kept "alive" rather than "dead." In such a case, the entity maintains operations but reorganizes its assets as a means to repay creditors. Today, however, this needed tool has provided some of the country's largest economic players with a sort of liability shield, allowing them to avoid substantial legal accountability, particularly in tort. Non-debtor release forms, which shield corporate officers from corporate conduct, courts' liberal use of the automatic stay, and the "Texas Two-Step," which effectively permits a company to reorganize under the laws of a different state, have incentivized companies to file for Chapter 11 in the hopes of evading liability. In addition, due to the lack of any real "good faith" or "insolvency" requirement in the Code, financially solvent corporations have been able to file for bankruptcy to temporarily, or permanently, suspend individual lawsuits and state regulation. This is not to say the tenets of corporate reorganization rested upon need be abandoned, the case is quite the opposite, but legislative reform is necessary to prevent the weaponization of the Code. The Chapter 11 shield may only be used by a few, but its impact remains significant.

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I. INTRODUCTION

Generally, when a company files for Chapter 11 bankruptcy, rather than liquidating its assets in an effort to repay creditors, its continues operations and reorganizes its assets into debt.[1] This form of bankruptcy reasons that, in particular circumstances, the entity's assets would be more valuable if it continued generating profits, rather than undergoing a complete liquidation.[2] "[T]he central goal of Chapter 11 is to create a viable economic entity by reorganizing the debtor's debt structure."[3]

The need for reorganization arose during an era of "over-building" in the railroad industry. In order to alter the unfavorable fate of several insolvent railroad companies, it became obvious complete liquidation of each entity "would not be as great as the gains from letting the railroads continue to operate."[4] Yet, in recent years, several high-profile corporations have found a way to use reorganization as a shield, despite any threat of bankruptcy on their horizon, allowing them to evade legal liability and government oversight.[5] The use of reorganization as a shield has substantial and real-world effects on individual lives.

Purdue Pharma ("Purdue"), a pharmaceutical company and maker of the opioid, OxyContin, has been considered largely responsible for the current opioid epidemic in the United States that has addicted hundreds of thousands of Americans and taken more than 200,000 lives.[6] In 2019, the company began facing thousands of lawsuits brought by victims, victims' estates, and local governments, all claiming Purdue ran misleading marketing campaigns that intentionally downplayed the addictiveness of the drug.[7] Consequently, Purdue filed for reorganization in an effort to settle the lawsuits and protects its owners, the Sackler family, from civil tort liability through the use of non-debtor releases.[8] These releases shield non-debtors with an identity of interest to the debtor, normally corporate officers and directors, from civil actions brought by parties in interest.[9]

The Sackler family profited nearly $13 billion over the course of 20 years and played a pivotal and divisive role in the false marketing and distribution of OxyContin.[10] In September 2021, Purdue's reorganization plan, including the non-debtor releases, was approved by a federal bankruptcy court.[11] Three months later, on appeal, the United States District Court for the Southern District of New York

1. 11 U.S.C. § 1101. *See also Chapter 11 Bankruptcy*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/chapter_11_bankruptcy (last modified July 2022).
2. LEGAL INFORMATION INSTITUTE, *supra* note 1.
3. *Id.*
4. Eliza Brooke, *Why Businesses that Declare Bankruptcy Don't Always Die*, VOX (Mar. 11, 2019, 12:20 PM), https://www.vox.com/the-goods/2019/3/11/18259894/bankruptcy-business-chapter-11-close-stores.
5. *See id.*
6. *In Numbers: Sackler Family, Purdue Pharma and the US Opioid Crisis*, BBC NEWS (Sept. 16, 2019), https://www.bbc.com/news/world-us-canada-49718388.
7. *Id.*
8. Jan Hoffman & Mary W. Walsh, *Purdue Pharma, Maker of OxyContin, Files for Bankruptcy*, N.Y. TIMES, https://www.nytimes.com/2019/09/15/health/purdue-pharma-bankruptcy-opioids-settlement.html (last modified Nov. 24, 2020).
9. Ashraf Mokbel, *The Permissibility of Chapter 11 Non-Debtor Release Provisions*, 7 ST. JOHN'S BANKR. RSCH. LIBR. 1, 1 (2015).
10. Jarod S. Hopkins and Andrew Scurria, *Sacklers Received as Much as $13 Billion in Profits from Purdue Pharma*, WALL ST. J. (Oct. 4, 2019), https://www.wsj.com/articles/sacklers-received-12-billion-to-13-billion-in-profits-from-OxyContin-maker-purdue-pharma-11570221797.
11. Hoffman & Walsh, *supra* note 8.

vacated the bankruptcy court's order.[12] The releases would shield the Sackler family from all civil claims potentially brought by victims and their families.[13]

Reorganization has not only been used to shield corporate officers from legal liability through non-debtor release forms but has also been used to maneuver past governmental regulation and oversight.[14] In 2020, New York's Attorney General sued the National Rifle Association ("NRA"), a firearm lobbying group, on grounds of misspending and corruption, alleging the organization failed "to manage [its] funds and… [failed to] follow numerous state and federal laws, contributing to the loss of more than $64 million in just [3] years for the NRA."[15] Testimony showed that Wayne LaPierre, Chief Executive Officer of the NRA, used the organization's tax-exempt funds leisurely for "wedding expenses, private jet travel, and exotic get-aways."[16] The NRA subsequently filed for Chapter 11 in a Texas bankruptcy court, a last-ditch effort to reorganize under the laws of the State and evade New York regulation.[17] The bankruptcy plan was ultimately rejected by the federal bankruptcy judge, who stated that the NRA did not file the bankruptcy petition in good faith and sought to gain an "unfair litigation advantage" over the New York Attorney General.[18]

Companies and organizations have been able to leverage the Code, which ultimately seeks to repay creditors and turn reorganization into a device that permits accountability avoidance. These actions are not within the scope of reorganization and ultimately end up providing companies with an alternative, more flexible, legal system, that prevents some claimants from having their day in court. Although reorganization is an efficient way to repay creditors, in that it puts to use existing assets, legislative reform is necessary to prevent the weaponization of the Code.

This article will identify some of the concerns that Chapter 11 may pose, such as Purdue's use of non-debtor release forms and good faith concerns exampled by the NRA litigation. This article will further propose solutions to this problem, which include the enactment of legislation that restricts the use of non-debtor releases and the imposition of more stringent filing requirements.

II. A BRIEF HISTORY OF CORPORATE REORGANIZATION IN THE UNITED STATES

In order to understand the intent and purpose of reorganization under the Code, the conversation must first be framed in a historical context. Congressional authority to enact bankruptcy laws finds itself in Article 1, § 8, Clause 4 of the Constitution, which permits Congress to establish "uniform Laws on the subject of

12. *Id.*
13. *Id.*
14. Danny Hakim, *In Rebuke to N.R.A., Federal Judge Dismisses Bankruptcy Case*, N.Y. TIMES (May 11, 2021), https://www.nytimes.com/2021/05/11/us/nra-bankruptcy.html.
15. Danny Hakim, *New York Attorney General Sues N.R.A. and Seeks Its Closure*, N.Y. TIMES (Aug. 6, 2020), https://www.nytimes.com/2021/05/11/us/nra-bankruptcy.html; Press Release, New York Attorney General Letitia James, Attorney General James Files Lawsuit to Dissolve NRA (Aug. 6, 2020) (available at https://ag.ny.gov/press-release/2020/attorney-general-james-files-lawsuit-dissolve-nra).
16. Tim Mak, *Judge Dismisses NRA Bankruptcy Case, Heightening Risk for Dissolution of Group*, NPR (May 11, 2021, 4:43 PM), https://www.npr.org/2021/05/11/995934682/judge-dismisses-nra-bankruptcy-case-heightening-risk-for-dissolution-of-group.
17. Hakim, *supra* note 14.
18. *See* Press Release, Attorney General James Files Lawsuit to Dissolve NRA, *supra* note 15.

Bankruptcies throughout the United States."[19] Throughout the nineteenth century, Congress enacted various bankruptcy laws, but all were short-lived because they were either temporary responses to economic crises or they were too harsh on debtors.[20]

The first long-standing, substantive bankruptcy legislation was the Bankruptcy Act of 1898 ("the 1898 Act").[21] The 1898 Act "marked the beginning of the era of permanent federal bankruptcy legislation," and was the first to introduce, broadly, the concept of corporate reorganization.[22] Passage of the 1898 Act came at a time of over-production in the booming railroad industry, which had caused many railroad companies to go bankrupt.[23] To determine the best route in which insolvent railroads would repay their debts, it became apparent that "the cash generated by liquidating… assets… would not be as great as the gains from letting the railroads continue to operate."[24] Accordingly, these railroad companies would continue operating, but creditors would assume shareholder positions in the company, creating essentially an equity for debt exchange.[25]

Over subsequent years, judges rejected reorganization efforts by other industries, such as several manufacturing titans.[26] The rationale for reorganization as applied to railroads was that the railroad industry operated as a "quasi-public industry," deserving of judicial exception.[27] The railroad industry was "given subsidies and special privileges… [and] their corporate status had been granted in exchange for service to the public."[28] Moreover, due to the complexity of the industry's supply chain, it seemed too difficult to liquate; "[t]he railway, like a complicated machine, consists of a great number of parts, the combined action of which is necessary to produce revenue."[29] Simply put, the reorganization of railroads was the most effective way to alleviate the harm done to the financial well-being of the industry.

The next major development in bankruptcy law came in 1938, as Congress wrestled to cure the wrath of the Great Depression. Congress amended the 1898 Act with the introduction of the Chandler Amendments, which proscribed corporate reorganization into Chapter 10 of the Code.[30] The Chandler Amendments "included substantial provisions for reorganization of businesses."[31] They also allowed for a bankruptcy plan to "be filed by the *debtor*, any creditor or indenture trustee, the examiner if directed by the judge, or by a stockholder if the debtor has not been

19. U.S. CONST. art. I, § 8, cl. 4.

20. *A Brief History of U.S. Bankruptcy Law*, LAW OFF. OF MARK B. FRENCH (Dec. 15, 2014), https://www.markfrenchlaw.com/law-blog/2014/december/a-brief-history-of-u-s-bankruptcy-law.

21. Chad P. Pugatch, et al., *The Lost Art of Chapter 11 Reorganization*, 19 UNIV. FLA. J. L. & PUB. POL'Y 39, 42–49 (2009).

22. Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 23 (1995).

23. Brooke, *supra* note 4.

24. *Id.*

25. *Id.*

26. Bradley Hansen, *Bankruptcy Law in the United States*, ECON. HIST. ASS'N (Aug. 14, 2001), https://eh.net/encyclopedia/bankruptcy-law-in-the-united-states.

27. *Id.*

28. *Id.*

29. *Id.*

30. *A Brief History of Bankruptcy*, BANKR. DATA, https://www.bankruptcydata.com/a-history-of-bankruptcy (last visited Oct. 23 ,2022); Pugatch et al., *supra* note 21.

31. BANKRUPTCY DATA, *supra* note 30.

found insolvent."[32] This, notably, created the option of bankruptcy by *voluntary* initiative, as opposed to the debtor being hailed into bankruptcy proceedings. Due to its strict procedural rules and overall lack of availability, corporate reorganization remained relatively uncommon throughout the mid-twentieth century.[33]

However, modern bankruptcy law finds itself in the Bankruptcy Reform Act of 1978 ("the 1978 Act"), which changed the game for corporate reorganization, providing companies with vast flexibility in their ability to reorganize.[34] The 1978 Act merged Chapter 7 (railroad reorganizations), Chapter 10 (corporate reorganizations), Chapter 11 (arraignments), and Chapter 12 (real property arrangements) of the 1898 Act into one reorganization chapter: Chapter 11.[35] "Reorganizations under the new chapter 11 [sought] 'to retain the simplicity of an arrangement with unsecured private creditors while, at the same time, to make the more complex reorganization less cumbersome and quicker to process.'"[36]

Since 1898, Congress has slowly embraced a more expansive, flexible, and efficient reorganization process. Beginning with the 1898 Act, Congress and the courts were hesitant in allowing reorganization to be common practice. Yet, the 1978 Act vastly expanded the scope of Chapter 11 proceedings. In fact, many of the aims of the 1978 Act have come to fruition, and reorganization has provided companies, and creditors, with flexibility and control throughout bankruptcy proceedings. The expansive approach the 1978 Act posits is the rational one, but courts must keep in mind the spirit of 1898–that reorganization is a tool to be used when needed.

III. MODERN CHAPTER 11 BANKRUPTCY

Generally, when a business or individual is unable to pay its debts, the party has the option of filing in federal bankruptcy court for either Chapter 7 protection, which liquidates the debtor's assets, or Chapter 11 protection, which resolves the debtor's financial misfortunes through a reorganization plan.[37] "[T]he central goal of Chapter 11 is to create a viable economic entity by reorganizing the debtor's debt structure."[38] The majority of this analysis will focus on Chapter 11 as it pertains to the reorganization plan.

The process of Chapter 11 begins when a company or individual, usually a corporation, files a bankruptcy petition, which includes the reorganization plan, in a federal bankruptcy court.[39] The reorganization plan is "the central feature" of the Chapter 11 process.[40] *Tamir v. U.S. Trustee* announced that "the primary goal of

32. John Gerdes, *Corporate Reorganizations: Changes Effected by Chapter X of the Bankruptcy Act*, 52 HARV. L. REV. 1, 31–32 (1938) (emphasis added).

33. Gordon Bermant & Ed Flynn, *Outcomes of Chapter 11 Cases: U.S. Trustee Database Sheds New Light on Old Questions*, BANKR. BY NUMBERS 1, https://www.justice.gov/archive/ust/articles/docs/abi98febnumbers.pdf (last visited Oct. 27, 2022).

34. Jerry P. Sheppard, *When the Going Gets Tough, the Tough Go Bankrupt*, 1 J. MGMT. INQUIRY 183, 184, 191 (1992).

35. Don J. Miner, *Business Reorganization Under the Bankruptcy Reform Act of 1978: An Analysis of Chapter 11*, 1979 BYU L. REV. 961, 961 (1979).

36. *Id.* at 968.

37. *Chapter 7 vs. Chapter 11 Bankruptcy: What's the Difference?*, BLOOMBERG L. (Feb. 25, 2022), https://pro.bloomberglaw.com/brief/chapter-7-vs-chapter-11-bankruptcy.

38. LEGAL INFORMATION INSTITUTE, *supra* note 1.

39. *Id.*

40. *Id.*

Chapter 11… [is] to formulate a comprehensive reorganization plan that will ultimately rehabilitate financially distressed debtors" and should be a negotiated process "to induce compromise."[41] Creditors impacted by the reorganization plan can approve or reject it.[42] However, only *impaired* creditors are permitted to vote; impaired creditors are those that are impacted by the actual reorganization plan, such as an extension of the pay-out period.[43] After the company files for Chapter 11, it is termed a "debtor," yet, management still operates and controls the entity.[44]

Before a bankruptcy court confirms a reorganization plan, it must find, generally, that the plan: (a) is feasible; (b) was submitted in good faith; and (c) is in compliance with the other requirements outlined in the Code.[45] A court will then determines whether the plan is sufficiently detailed, so that "creditors can make informed decisions on whether to approve it."[46] For the class to accept the plan, over half of its voters must approve and "represent at least two-thirds of the dollar amount at stake for that class."[47] If the court finds that the plan satisfies these requirements, and the bankruptcy judge and all its creditors agree to the terms of reorganization, the plan is approved.[48]

The Act of 1978 created a more efficient, less costly form of corporate reorganization. Nevertheless, the process of reorganization is an arduous venture, that requires lots of cash.[49] Attorney's fees alone will "run about 4% of annual revenue. If your company has $2,000,000 in revenue, expect to pay between $75,000 and $100,000 to your bankruptcy lawyer… [and] expenses for accountants and other professionals on top of that."[50]

Yet, reorganization is still the more favorable option for companies, particularly because it is much less costly than liquidation.[51] Professor Samuel Antill at the Harvard Business School studied thirty years of Chapter 7 and Chapter 11 court filings, with the goal of determining how much each form of bankruptcy costs creditors.[52] Professor Antill found that "60 percent of the liquidations… studied cost creditors more than… reorganization would have."[53] Nevertheless, bankruptcy remains a risky venture. "About 25% of companies that file for Chapter 11 will survive—not exactly a great batting average, even in baseball."[54]

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41. *Id.* (quoting Tamir v. United States Tr., 566 B.R. 278, 283 (D. Me. 2016)).
42. LEGAL INFORMATION INTSTITUTE, *supra* note 1.
43. Paul Geilich, *Impaired Creditors and Your Chapter 11 Bankruptcy Plan*, LAWS. (Apr. 9, 2015), https://www.lawyers.com/legal-info/bankruptcy/commercial-bankruptcy/impaired-creditors-and-your-chapter-11-plan.html.
44. Robert Bovarnick, *What You Need to Know About Chapter 11*, FORBES (Sept. 25, 2008, 6:35 PM), https://www.forbes.com/2008/09/25/chapter-11-bankruptcy-ent-law-cx_rb_0925bovarnick-chap11.html?sh=dcfb4d3d003a.
45. *Chapter 11 – Bankruptcy Basics*, U.S. CTS., https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Oct. 23, 2022).
46. Bovarnick, *supra* note 44.
47. *Id*.
48. UNITED STATES COURTS, *supra* note 45.
49. Rachel Layne, *Bankruptcy Spells Death for Too Many Businesses*, HARV. BUS. SCH. (July 20, 2021), https://hbswk.hbs.edu/item/why-bankruptcy-spells-death-for-too-many-businesses.
50. Bovarnick, *supra* note 44.
51. Layne, *supra* note 49.
52. *Id. See* Professor Samuel Antill, *Do the Right Firms Survive Bankruptcy?*, 144 J. FIN. ECONS. 523, 529 (2022).
53. Layne, *supra* note 49; Antil, *supra* note 52, at 524.
54. Bovarnick, *supra* note 44.

A. Non-Debtor Release Forms

Generally, a non-debtor release "shields third parties who share an identity of interest with the debtor, usually corporate officers and directors in a Chapter 11 proceeding, from any claim, obligation, cause of action, or liability to any party in interest who has filed a claim or been given notice of the debtor's bankruptcy."[55] As in the case of Purdue, a non-debtor release form included in a reorganization plan may allow a corporate officer to evade due liability, preventing certain tort claimants from "their day in court."[56] In the circuits that authorize the use of non-debtor release forms, the statutory basis for them finds itself in § 105 of the Code, which provides that, "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." [57]

"The clear majority (the First, Second, Third, Fourth, Sixth, Seventh, Eleventh, and D.C. Circuits) have determined that [non-debtor] releases and injunctions under a plan are authorized in appropriate, narrow circumstances."[58] In *In re Dow Corning Corp.*, the Sixth Circuit held that the Code does not expressly proscribe a bankruptcy court "to enjoin a non-consenting credit's claims against a non-debtor to facilitate a reorganization plan." [59]

The Fifth, Ninth, and Tenth Circuits forbid such releases.[60] These circuits interpret § 524(e) of the Code, which states that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity, for such debt," as precluding the grant of non-debtor releases.[61] The Fifth Circuit has held that § 524(e) "only releases the debtor, not co-liable third parties."[62]

In the circuits that permit non-debtor releases, bankruptcy courts generally consider: (a) "the identity of interests between the debtor and the third party"; (b) "whether the non-debtor has contributed substantial assets to the reorganization"; (c) "whether the release is essential to reorganization"; (d) "whether the impacted classes of claims have overwhelmingly accepted the plan"; and (e) "whether the court has made a record of specific factual findings to support such releases."[63]

"Testimony given before the House Committee discussed how plans of reorganization proposed in Purdue Pharma, USA Gymnastics, Boy Scouts of America, and various Christian diocese bankruptcy cases contain such releases and how these releases could negatively impact tort claimants who are victims of egregious acts."[64] Although the use of non-debtor releases is approved of in "narrow circumstances,"

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55. Mokbel, *supra* note 9, at 1.

56. *Id.*

57. 11 U.S.C. §105(a); *Congressional Committees Propose Changes to Bankruptcy Code Prohibiting Non-Consensual Releases of Third Parties and Limiting Other Important Bankruptcy Tools*, GIBSON DUNN (Aug. 2, 2021), https://www.gibsondunn.com/congressional-committees-propose-changes-to-bankruptcy-code-prohibiting-non-consensual-releases-of-third-parties-and-limiting-other-important-bankruptcy-tools.

58. *In re* Purdue Pharma L.P., 633 B.R. 53, 100 (Bankr. S.D.N.Y. 2021).

59. Mokbel, *supra* note 9, at 7.

60. GIBSON DUNN, *supra* note 57.

61. *Purdue Pharma*, 633 B.R. at 101; 11 U.S.C. § 524(e).

62. *In re* Pac. Lumber Co., 584 F.3d 229, 252 (5th Cir. 2009).

63. GIBSON DUNN, *supra* note 57.

64. Kyle F. Arendsen & Peter R. Morrison, *Congress Proposes Significant Bankruptcy Code Changes to Protect Tort Claimants and Creditors, But What are the Real Consequences,* NAT'L L. REV. (Aug. 11, 2021), https://www.natlawreview.com/article/congress-proposes-significant-bankruptcy-code-changes-to-protect-tort-claimants-and.

Purdue's reorganization plan has garnered public scrutiny into the potentially disastrous impacts that may accompany the releases. Despite recklessly marketing OxyContin for 20 years, which resulted in widespread opioid addiction throughout the United States, the Sackler family will remain relatively unscathed in their legal battles, retaining much of the wealth made from its opioid product.

Non-debtor release forms are not the only way a corporation may use Chapter 11 to shield itself from ongoing litigation. A substantial advantage in filing a reorganization petition is the power of the "automatic stay," which halts "all existing litigation against the debtor and all efforts to collect on pre-petition debts."[65] The stay is triggered upon filing and continues through proceedings.[66] In some cases, a creditor may seek relief from the stay, allowing it to pursue payment or foreclosure.[67] In Purdue's case, "civil litigation against [them] came to a halt . . [and] litigation against certain members of the Sackler family was also abated during the pendency of the bankruptcy cases."[68]

Whether it be non-debtor releases or the automatic stay, Chapter 11 provides an advantage to companies that seek to halt incoming litigation temporarily, or permanently. A vast majority of Chapter 11 filings benefit from these consequences of reorganization, in good faith. Yet, courts must recognize when Chapter 11 is pursued as a strategy.

B. Corporate Insolvency and the Good Faith "Requirement"

Since the Chandler Amendments, debtors have been permitted to initiate bankruptcy proceedings voluntarily.[69] Additionally, the 1978 Act provided that debtors are not required to be financially insolvent to file for Chapter 11, but that it is a factor in determining whether there was a good faith filing.[70]

"'Bad faith' is not listed in [§] 1112(b)(4) [of the Code], [but] courts have consistently found that the absence of good faith in connection with the *filing* of a Chapter 11 case is cause for dismissal or conversion."[71] Conversely, § 1129(b)(3) requires that, before a reorganization plan can be *approved*, it must be "proposed in good faith and not by any means forbidden by law."[72] Nevertheless, whether a filing was made in good faith is a key inquiry in determining whether bankruptcy proceedings should proceed after a filing.[73] In *In re Emmons-Sheepshead Bay Dev. LLC*, the court stated that good faith means "proposed with honesty and good intentions, and with a basis for expecting that reorganization can be effected."[74]

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65. Bovarnick, *supra* note 44.
66. 11 U.S.C. § 362(a).
67. 11 U.S.C. § 362(d); UNITED STATES COURTS, *supra* note 45.
68. *In re Purdue Pharm L.P.: S.D.N.Y. Holds Bankruptcy Court Lacks Statutory Authority to Approve Sackler Family Releases*, JD SUPRA (Dec. 28, 2021), https://www.jdsupra.com/legalnews/in-re-purdue-pharma-l-p-s-d-n-y-holds-2631948.
69. Gerdes, *supra* note 32, at 3–4 .
70. *Id.* at 8–9.
71. Mark Douglas & Jane R. Wittstein, *Patently Abusive Chapter 11 Cases Filed by Non-Financially Distressed Companies Dismissed for Bad-Faith,* JD SUPRA, https://www.jdsupra.com/post/contentViewerEmbed.aspx?fid=d573c030-b6fd-42bb-acf7-10304a4267ea (last visited Oct. 23, 2022).
72. § 1129(b)(3).
73. Douglas & Wittstein, *supra* note 71.
74. *In re* Emmons-Sheepshead Bay Dev. LLC, 518 B.R. 212, 225 (E.D.N.Y. 2014).

In *In re Integrated Telecom Express, Inc.,* the court found that a Chapter 11 petition is filed in good faith if it serves a "valid bankruptcy purpose," as opposed to "merely obtaining a tactical litigation advantage."[75] In *Telecom Express*, broadband supplier, Telecom Express, entered into a ten-year lease in Silicon Valley, for $200,000 a month.[76] Soon thereafter, the company's shareholders filed a $5 million class-action lawsuit after Telecom lost nearly $36 million due to the product market.[77] Despite the product failure, the company was solvent, holding over $106 million in assets and $430,000 in liabilities.[78] Nevertheless, Telecom sent the landlord a letter threatening to file for Chapter 11 bankruptcy, which would limit the amount the landlord could recover.[79] The court held that Telecom filed for reorganization in bad faith because it attempted to gain a tactical litigation advantage over the landlord.[80]

In *Telecom Express*, the court found that two inquiries were relevant in determining whether a Chapter 11 filing should be dismissed for bad faith: (a) whether the petition "serves a valid bankruptcy purpose," either by "preserving a going concern" or "maximizing the value of the debtor's estate"; and (b) whether the petition was filed to obtain a "tactical litigation advantage."[81]

Telecom Express also stated that although financial insolvency is not a requirement for a Chapter 11 filing, it is a relevant factor in determining whether the petition was filed in good faith.[82] The Court explained that a debtor must be able to "rehabilitate its business before it is faced with a hopeless situation."[83] However, it further stated that it "does not open the door to premature filing."[84] There must be some form of "financial distress."[85] Therefore, the court may dismiss Chapter 11 filings "filed by financially healthy companies with no need to reorganize."[86] Although the court found that Telecom had undergone economic difficulties, it did not find that Chapter 11 proceedings offered Telecom "any relief" from such distress, because it had "no relation to any debt owed" by Telecom.[87]

Because a company need not be insolvent to file for Chapter 11, they have been provided with substantial flexibility in deciding when and under what circumstances to file, allowing the company to, "almost at will… escape from most any undesirable financial obligations… the discretionary nature of the [1978 Act] prompted many to think of bankruptcy as a strategy… and research has suggested that under some circumstances bankruptcy may be effectively used as a strategic tool for helping create value for the shareholder."[88] Moreover, because the filing decision is voluntary, there exists an "obvious incentive to file in friendly courts

75. *In re* Integrated Telecom Express, Inc., 384 F.3d 108, 119–20 (3d Cir. 2004).
76. *Id.* at 112.
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.* at 129.
81. *Id.* at 121.
82. *Id.* (quoting *In re* SGL Carbon Corp., 200 F.3d 154, 163 (3d Cir. 1999)).
83. *Id.*
84. *Id.*
85. *Id.* (quoting *SGL Carbon Corp.*, 200 F.3d at 163).
86. *Id.*
87. *Id.* at 122, 129.
88. Sheppard, *supra* note 34, at 183–84.

and… to push for reorganization and the preservation of their jobs."[89] The voluntary nature of bankruptcy also allows the corporation to express its interests to the bankruptcy judge, even when such interests may not be relevant to the present dispute.[90] "[B]eneficiaries of reorganization efforts… have great incentives to participate in the bankruptcy case and to make their interests known to the judge."[91] For example, imagine a corporation that initiates bankruptcy proceedings to resolve thousands of lawsuits stemming from tortious conduct. When the corporation files in bankruptcy court, the company may make its economic interests known to the judge; such interests would hardly be relevant in the alternative case.

One of the earliest examples of a corporation using Chapter 11 bankruptcy for strategy in the absence of an insolvency requirement occurred just four years after the passage of the 1978 Act.[92] In 1982, the Johns-Manville Corporation filed for Chapter 11 as it faced a large number of third-party lawsuits by those injured as a result of asbestos exposure.[93] Under the corporation's reorganization plan, the plan created a separate fund in which the lawsuits would be brought, while business operations at the corporation's facilities continued nearly unscathed.[94] *In re Johns-Manville Corp* "has been questioned in some bankruptcy literature as lacking the elements of a good faith filing [because the] filing was intended to cut off future product liability claims and to enable the rest of the company to continue operating without the burden of those claims[.]"[95]

Johns-Manville is an example of how a corporation may evade liability and weaponize Chapter 11 as an alternative legal resolution: the bankruptcy courts. By using reorganization as a form of strategy, powerful, asset-rich companies have been able to protect their financial and ownership interests in the face of economic and legal consequences. Such bankruptcy maneuvers have, in effect, turned Chapter 11 into a unique form of alternative dispute resolution.

IV. THE SHIELD IN ACTION

This section will explore how some of today's largest organizations and companies have used Chapter 11 as a shield, whether that be to evade legal liability or state regulation and oversight.

A. Evading Opioid Litigation with Non-Debtor Release Forms

From 1999 through 2019, an estimated 500,000 people died from an opioid overdose.[96] Of these deaths, *prescription* opioids accounted for nearly 247,000 of

89. Todd J. Zywicki, *Bankruptcy*, ECONS. LIBR., https://www.econlib.org/library/Enc/Bankruptcy.html (last visited Oct. 23, 2022).
90. *Id.*
91. *Id.*
92. Walker F. Todd, *Aggressive Uses of Chapter 11 of the Federal Bankruptcy Code*, 3 ECON. REV. 20, 20 (1986).
93. *Id.* at 23.
94. *Id.*
95. *Id. See generally In re* Johns-Manville Corp., 581 B.R. 38 (Bankr. S.D.N.Y. 2018).
96. *Understanding the Epidemic*, CTRS. FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/opioids/basics/epidemic.html (last visited Nov. 10, 2021).

them.[97] "Overdose deaths involving prescription opioids were more than four times higher in 2019 than in 1999."[98]

Due to this epidemic, many opioid distributors and makers have fallen under legal fire for their permissiveness to the outbreak. Accordingly, there have been several Chapter 11 filings by opioid makers to resolve mass tort litigation.[99] The four largest U.S. pharmaceutical and drug distribution companies, including Johnson & Johnson, recently notified the public of a settlement potentially worth up to $26 billion.[100] Perhaps though, the most infamous in today's headlines is Purdue's reorganization plan. [101]

Purdue, owned by the Sackler family, is a pharmaceutical company that began producing and distributing OxyContin, an intense opioid pain reliever, in 1996.[102] Almost immediately after Purdue began selling OxyContin, concerns about the drug's addictiveness and the company's "aggressive" marketing strategies came to light.[103] In the early 1990s, internal Purdue emails indicated the company's plans for "targeting OxyContin to non-cancer patients with chronic pain, and how the company aggressively fought off threats to its blockbuster's sales, even as the opioid epidemic took hold."[104]

In 2007, Purdue plead guilty to a felony charge for "misbranding" OxyContin in their marketing and promotional campaigns.[105] The Court fined the company $634.5 million and required the company's top three executives to perform community service.[106] In 2020, Purdue and the Department of Justice reached an $8 billion settlement.[107] Under its terms, Purdue agreed to admit the company conspired to defraud the United States and violated anti-kickback laws in the distribution of OxyContin; the anti-kickback violations "included payments the firm made to healthcare companies and doctors to encourage prescribing the drugs, which were ultimately paid for by public health programs."[108]

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97. *Drug Overdose*, CTRS. FOR DISEASE CONTROL AND PREVENTION, https://www.cdc.gov/drugoverdose/deaths/prescription/overview.html (last visited Nov. 10, 2021).

98. *Id.*

99. Brian Mann, *Corporate Opioid Payouts Now Being Finalized Would Top $32 Billion*, NPR (Feb. 23, 2022, 6:00 AM), https://www.npr.org/2022/02/23/1082237366/corporate-opioid-payouts-would-top-32-billion.

100. Geoff Mulvihill, *Judge Conditionally Approves Purdue Pharma Opioid Settlement*, AP NEWS (Sept. 1, 2021), https://apnews.com/article/purdue-pharma-opioid-settlement-6fd3e10dcd6b0eeffd2f0b885efd4693.

101. GIBSON DUNN, *supra* note 57.

102. Art Van Zee, *The Promotion and Marketing of OxyContin: Commercial Triumph, Public Health Tragedy*, NAT'L INST. OF HEALTH (Feb. 2009), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC2622774.

103. Shraddha Chakradhar & Casey Ross, *The History of OxyContin, Told Through Unsealed Purdue Documents*, STAT NEWS (Dec. 3, 2019), https://www.statnews.com/2019/12/03/OxyContin-history-told-through-purdue-pharma-documents.

104. *Id.*

105. Barry Meier, *Origins of an Epidemic: Purdue Pharma Knew Its Opioids Were Widely Abused*, N.Y. TIMES (May 29, 2018), https://www.nytimes.com/2018/05/29/health/purdue-opioids-OxyContin.html.

106. *Id.*

107. Brian Mann, *Federal Judge Approves Landmark $8.3 Billion Purdue Pharma Opioid Settlement*, NPR (Nov. 17, 2020, 9:27 PM), https://www.npr.org/2020/11/17/936022386/federal-judge-approves-landmark-8-3-billion-purdue-pharma-opioid-settlement.

108. Natalie Sherman, *Purdue Pharma to Plead Guilty in $8bn Opioid Settlement*, BBC NEWS (Oct. 21, 2020), https://www.bbc.com/news/business-54636002.

Purdue persisted. From 1996 to 2020, Purdue managed to profit an estimated $35 billion from its sales of OxyContin.[109] The Sackler family profited nearly $13 billion over the course of 20 years, playing a pivotal and divisive role in the false marketing and distribution of OxyContin.[110]

In 2019, the company faced lawsuits in 24 states, 2,600 lawsuits from local governments, and 138,000 lawsuits from private individuals.[111] All of the lawsuits challenged Purdue's false marketing claims as to the addictiveness of opioids.[112] The Department of Justice found that Purdue aggressively marketed its opioid products in an attempt to conceal the extent of the drug's addictiveness and overdose risks.[113]

In September 2019, Purdue filed for Chapter 11 in the United States Bankruptcy Court for the Southern District of New York.[114] Due to the automatic stay, all pending civil litigation against Purdue and certain Sackler family members ceased.[115] In September 2021, the company's reorganization plan received approval from the federal bankruptcy judge.[116] Under the plan, the company would be "reorganized into a new charity-oriented company with a board appointed by public officials and will funnel its profits into government-led efforts to prevent and treat addiction."[117] The plan would require Purdue and the Sacklers to pay nearly $11 billion in settling civil tort lawsuits and criminal penalties.[118] The Sackler family profited an estimated $13 billion from the opioid epidemic and Purdue nearly $35 billion.[119]

Only impaired creditors are permitted to vote—those impacted by the actual reorganization plan, like the extension of a pay-out period.[120] Accordingly, many of the families and individuals that were harmed by the drug did not have any ability to express their interests in bankruptcy court. "[M]any of the 138,000 individuals

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109. Laura Strickler, *Purdue Pharma Offers $10-12 Billion to Settle Opioid Claims,* NBC NEWS (Aug. 27, 2019, 1:32 PM), https://www.nbcnews.com/news/us-news/purdue-pharma-offers-10-12-billion-settle-opioid-claims-n1046526.

110. Brian Mann, *Sacklers Deny Wrongdoing During House Panel Over Purdue Pharma OxyContin Sales*, NPR NEWS (Dec. 17, 2020, 5:00 AM), https://www.npr.org/2020/12/17/947064266/sacklers-to-face-house-panel-over-purdue-pharma-OxyContin-sales.

111. Tom Hals, *OxyContin Maker Purdue Begins Bankruptcy in Push to Settle Opioid Lawsuits*, REUTERS (Sept. 17, 2019 6:06 AM), https://www.reuters.com/article/us-purdue-pharma-bankruptcy-hearing/OxyContin-maker-purdue-begins-bankruptcy-in-push-to-settle-opioid-lawsuits-idUSKBN1W217E.

112. *In Numbers: Sackler Family, Purdue Pharma and the US Opioid Crisis*, BBC NEWS (Sept. 16, 2019), https://www.bbc.com/news/world-us-canada-49718388; Amanda Robert, *Judge Approves Purdue Pharma Bankruptcy Plan That Provides Immunity to Sackler Family Members,* ABA J. (Sept. 2, 2021), https://www.abajournal.com/news/article/judge-to-approve-purdue-pharma-bankruptcy-plan-that-provides-company-owners-immunity; Martha Bebinger, *The Purdue Pharma Deal Would Deliver Billions, But Individual Payouts Will Be Small*, NPR NEWS (Sep. 28, 2021, 5:00 AM), https://www.npr.org/2021/09/28/1040447650/payouts-purdue-pharma-settlement-sackler.

113. *Purdue Pharma Files For Bankruptcy in the US*, BBC NEWS (Sept. 16, 2019), https://www.bbc.com/news/business-49711618.

114. *In re* Purdue Pharma L.P., 633 B.R. 53 (Bankr. S.D.N.Y. 2021).

115. JD SUPRA, *supra* note 68.

116. *Purdue Pharma*, 633 B.R. at 115.

117. Mulvihill*, supra* note 100.

118. Jeremy Hill, *Sacklers to Exit From Complex Purdue Bankruptcy With Billions,* BLOOMBERG WEALTH (Sept. 1, 2021), https://www.bloomberg.com/news/features/2021-09-01/sackler-family-exits-bankruptcy-trial-over-purdue-pharma-s-OxyContin.

119. *Id.*

120. Geilich, *supra* note 43.

who've filed claims for a death, expenses tied to their addiction or the birth of a child exposed to opioids during pregnancy expect to receive little if anything from the deal."[121] Nearly 90% of the settlement will go to states and local governments.[122] "[T]his settlement is different because it was negotiated in bankruptcy court and there was a fixed pot of money. Lawyers representing individuals and all the states disagreed about how to divide it. Some attorneys who followed the proceedings say states had the advantage and prevailed."[123]

In exchange for the agreement, the Sacklers, along with the other corporate officers, would be released from all civil liability that relates to Purdue's business operations.[124] Sackler family members would be provided with non-debtor releases, insulating them from civil tort lawsuits that arise as a result of the company's conduct during the opioid epidemic.[125] This includes victims that were injured as a result of OxyContin, family members that lost loved ones to the drug, and communities that were ravaged by drug addiction.

The bankruptcy court found that it had the statutory authority to approve the non-debtor releases pursuant to sections 105(a), 1123(a)(5), 1123(b)(6), and 1129 of the Code.[126] Specifically, § 105 provides that, "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[127]

David Sackler testified family members would have refused to accept the plan unless it protected them from civil litigation, otherwise, the family would drown in litigation that dragged on for years, eating up the company's and family's assets in fees.[128] The contention has weight to it. In fact, the court agreed: it is "clear that the monetary contributions by the Sacklers and their related entities are critical of confirmation of the plan. Without the settlement payments… the plan would unravel, including the complex interrelated settlements that depend upon the payments being supplied under the settlement."[129] Additionally, "if I denied confirmation of the plan, the objectors' aggregate net recovery on their claims against the Debtors *and* the shareholder released parties would be materially less than their recovery under the plan. "[130]

On appeal, in December 2021, the United States District Court for the Southern District of New York vacated the bankruptcy court's order.[131] This is a significant decision, because the district court resides in the Second Circuit, a jurisdiction "permissive" of non-debtor release forms.[132] The court's decision "places in substantial doubt" the future of such releases in the Second Circuit.[133] Here, the court

121. Bebinger, *supra* note 112.
122. *Id.*
123. *Id.*
124. Brian Mann, *OxyContin-Maker Purdue Pharma Launched A Stealth Campaign To Sway U.S. Officials*, NPR (Aug. 31, 2021, 4:14 PM), https://www.npr.org/2021/08/31/1032778376/purdue-pharma-bankruptcy-doj-justice-department-sackler-OxyContin-opioid.
125. *Id.*
126. *In re* Purdue Pharma, L.P., 635 B.R. 26, 95 (S.D.N.Y 2021).
127. 11 U.S.C. § 105(a).
128. Mulvihill, *supra* note 100.
129. *In re* Purdue Pharma, L.P., 633 B.R. 53, 135 (Bankr. S.D.N.Y. 2021).
130. *Id.* at 109.
131. *In re* Purdue Pharma, L.P., 635 B.R. 26, 38 (S.D.N.Y. 2021).
132. *Id.* at 78.
133. *S.D.N.Y. Holds Bankruptcy court Lacks Statutory Authority to Approve Sackler Family Releases*, *supra* note 68.

explicitly concluded that § 105 of the Code did not give a bankruptcy court any substantive authority to issue the non-debtor releases.[134] The district court also fought back at the idea that the issuance of the releases is a settled issue in the Circuit.[135] The court "cautioned that statutory authority for non-consensual, non-debtor releases outside the asbestos context was at best uncertain."[136]

Generally, judicial and economic efficiencies are understandable considerations in determining the permissibility of such releases. Not only would the Sackler family drown in litigation for the foreseeable future, but many of the injured individuals and their families may not even collect. Purdue's reorganization plan initiates this process. Nevertheless, bankruptcy courts are not the forum many of these suits should be conducted in. In bankruptcy courts, a company has the advantage of expressing its corporate officers' interests and the company's financial stake.

The purpose of a reorganization proceeding is to provide the company with a "fresh start," not to provide a corporation with an alternative dispute platform where it gets to express its interests. "[N]on-debtor parties are not the entities seeking a 'fresh start,' as they have not filed their own bankruptcy proceedings."[137] These bankruptcy proceedings merely evade the judicial process, prohibiting those injured from having their day in court. As § 524(e) of the Code provides, a "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity, for such debt."[138]

B. Evading Talc Baby Powder Litigation with the "Texas Two-Step"

Another way in which companies have been able to evade mass tort liability is through a procedural bankruptcy technique often termed the "Texas Two-Step."[139] In October 2021, Johnson & Johnson employed this technique and filed for Chapter 11 in Texas as it faced nearly 40,000 lawsuits, mostly from women, claiming that Johnson & Johnson's distribution of talc baby powder "was contaminated with asbestos" that caused "ovarian cancer… [and] mesothelioma in thousands of individuals."[140] In so doing, it temporarily halted all lawsuits against them–many of those claims held by individuals and their families who were harmed by the baby powder.[141]

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134. JD SUPRA, *supra* note 68.
135. *Purdue Pharma*, 635 B.R. at 37–38.
136. JD SUPRA, *supra* note 68.
137. *Releasing Non-debtors Through a Chapter 11 Plan of Reorganization,* AM. BANKR. INST. (Dec. 1, 2000), https://www.abi.org/abi-journal/releasing-non-debtors-through-a-chapter-11-plan-of-reorganization.
138. 11 U.S.C. § 524(e).
139. Amelia S. Ricketts & Jin Lee, *Senate Judiciary Committee Subcommittee Hearing on the "Texas Two-Step": A Recap*, HARV. L. SCH. 1 (Feb. 22, 2022), https://blogs.harvard.edu/bankruptcyroundtable/2022/02/22/senate-judiciary-committee-subcommittee-hearing-on-the-texas-two-step-a-recap.
140. Norman N. Kinel, *The Bankruptcy Court's Ruling is in: J&J's Texas Two-Step Does Not Constitute a Bad Faith Filing*, NAT'L L. REV. (Sept. 28, 2022), https://www.natlawreview.com/article/texas-two-step-firestorm-no-dance. *See also* Brian Mann, *J&J Tried to Block Lawsuits from 40,000 Cancer Patients, A Court Wants Answers*, NPR (Sept. 27, 2022, 2:51 PM), https://www.npr.org/2022/09/19/1123567606/johnson-baby-powder-bankruptcy-lawsuits.
141. Ricketts & Lee, *supra* note 139, at 3.

The "Texas Two-Step" is a complex procedural process, but can generally be broken down into two steps, hence its name. The first step occurs when a company, Company A, reorganizes under the laws of Texas or Delaware—jurisdictions historically favorable to corporate debtors—and divides itself into two or more new entities, also known as a "divisive merger."[142] From here, Company B, the new entity, assumes all the liabilities of Company A.[143] In step 2, Company B files for bankruptcy, "thereby shielding some or all of the assets of [Company A] from creditors, while providing [Company B] with the shield of the automatic stay."[144] Accordingly, Company B "takes the heat" for Company A and its affiliates.

Here, Johnson & Johnson equipped the tactic "to address an 'explosion' of claims and a 'deluge of litigation' against its Johnson & Johnson Consumer Inc. subsidiary."[145] The company, headquartered in New Jersey, relocated to Texas and essentially split itself in two, creating a smaller subsidiary known as LTL Management ("LTL"), which assumed many of its liabilities, but none of the company's operations.[146] Johnson & Johnson, the other remaining half of the company, "was able to transfer all of the potential liability linked to the tsunami of baby powder asbestos claims into the shell of [LTL], while keeping valuable assets separate."[147] The company then "funded LTL with $2 billion to pay tort claimants."[148]

From here, LTL filed for bankruptcy and invoked the automatic stay, thereby shielding many of Johnson & Johnson's assets.[149] The talc claimants then moved to dismiss the case, in part, for lack of good faith, alleging that Johnson & Johnson's subsidiary was created "as a special purpose vehicle, with the state purpose… to employ the bankruptcy's automatic stay… for the benefit of its solvent operating" entity.[150] The United States Bankruptcy Court for the District of New Jersey refused to dismiss the case for lack of good faith, finding that Johnson & Johnson did not abuse bankruptcy proceedings by creating a subsidiary in Texas.[151] The bankruptcy court found "nothing inherently unlawful or improper with the application of the Texas divisional merger," and that, "the rights of the talc claimants and holders of future demands are materially affected."[152] Accordingly, the court could not conclude that that case the case should be dismissed for lack of good faith, because the "use of the statute as undertaken in this case… [does not] evidence bad faith."[153] Moreover, the court found that although Johnson & Johnson was not financially insolvent, it made its filing "with the expressed aim of addressing the present and

142. Kinel, *supra* note 140.
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.*
147. Brian Mann, *Rich Companies Are Using a Quiet Tactic to Block Lawsuits: Bankruptcy*, NPR (Apr. 2, 2022, 7:00 AM), https://www.npr.org/2022/04/02/1082871843/rich-companies-are-using-a-quiet-tactic-to-block-lawsuits-bankruptcy.
148. Daniel Gill, *J&J Talc Bankruptcy 'Bad Faith' Claims Go Before Third Circuit*, BLOOMBERG L. (Sept. 19, 2022, 4:00 AM), https://news.bloomberglaw.com/bankruptcy-law/j-j-talc-bankruptcy-bad-faith-claims-go-before-third-circuit.
149. *Id.*
150. *In re* LTL Mgmt., 637 B.R. 396, 408 (Bankr. D.N.J. 2022).
151. *Id.* at 406.
152. *Id.* at 427.
153. *Id.* at 428.

future liabilities associated with ongoing global personal injury claims to preserve corporate value."[154]

The judge stated Johnson & Johnson's case confirms "the horrible truth that many of these cancer victims will not live to see their cases through the trial and appellate systems."[155] Despite the court's acknowledgment of Johnson & Johnson's disastrous actions, the court found that justice would be best served "by expeditiously providing critical compensation through a court-supervised, fair, and less costly settlement trust arrangement."[156] As stated previously in this article, this misses the point. Bankruptcy courts are not meant to be a shortcut from litigation, regardless of the liability and cost.

The "Texas Two-Step" is yet another way in which large companies have been able to evade the judicial process and liability through Chapter 11 bankruptcy. The purposes of reorganization have been ignored, as bankruptcy courts are not thought of as expedited judicial proceedings, a way to avoid actual accountability.

C. Evading State Regulation and Bad Faith Filings

Chapter 11 Bankruptcy has also been used as a shield to evade state regulation and oversight, signaling the issues involved when financially healthy organizations fail to file in good faith. In 2021, the NRA filed for reorganization in a Texas bankruptcy court to dodge regulatory action by the New York Attorney General.[157] Specifically, the organization had been found to violate several anti-corruption laws.[158] Similar to Johnson & Johnson, the NRA employed the "Texas Two-Step."[159]

In 1871, the NRA was founded, and given a charter, in New York.[160] The organization operated as a recreational group designed to "promote and encourage rifle shooting on a scientific basis."[161] Today, the organization is one of the "most powerful special interest [gun] lobby groups."[162] The NRA describes itself as "America's foremost defender of Second Amendment rights" and the "premier firearms education organization in the world."[163]

In 2017, New York Attorney General, Letitia James, began investigating the NRA for a potential compliance breach with state not-for-profit law.[164] Three years later, James sued the organization for misspending and corruption in "failing to manage the NRA's funds and failing to follow numerous state and federal laws,

154. *Id.* at 407.
155. *Id.* at 429–30.
156. *Id.* at 430.
157. Danny Hakim & Mary W. Walsh, *The N.R.A. Wants to 'Dump' Its Regulators via Bankruptcy. Will It Succeed?*, N.Y. TIMES (May 11, 2021), https://www.nytimes.com/2021/01/21/business/nra-bankruptcy-new-york.html.
158. Hakim, *supra* note 15. *See* Press Release, Attorney General James Files Lawsuit to Dissolve NRA, *supra* note 15.
159. Roy Strom, *How Suspended Lawyer Derailed NRA Donors' $1Billion Claim*, BLOOMBERG L. (Aug 10, 2002, 9:28 AM), https://news.bloomberglaw.com/business-and-practice/how-suspended-lawyer-derailed-a-1-billion-claim-against-the-nra.
160. *A Brief History of the NRA*, NRA, https://home.nra.org/about-the-nra (last visited Oct. 24, 2022).
161. *US Gun Control: What is the NRA and Why is it so Powerful?,* BBC NEWS (May 27, 2022), https://www.bbc.com/news/world-us-canada-35261394.
162. *Id.*
163. NRA, *supra* note 160.
164. Hakim & Walsh, *supra* note 157.

contributing to the loss of more than $64 million in just three years for the NRA."[165] The testimony indicated that Wayne LaPierre, Chief Executive Officer, manipulated the organization's tax-exempt funds for "wedding expenses, private jet travel, and exotic getaways."[166]

In January 2021, in response to James' lawsuit, the NRA equipped the "Texas Two-Step" and filed for reorganization in the United States Bankruptcy Court for the Northern District of Texas.[167] The organization sought to reorganize under the laws of Texas, where it would be out of regulatory reach by New York.[168] The attorney representing the NRA argued that "[i]n the parlance of bankruptcy, we have a predatory lender who is seeking to foreclose on our assets."[169]

Later that year, in May, the court dismissed the case pursuant to § 1112(b)(4) of the Code on the grounds that the NRA did not file the petition in "good faith."[170] The Northern District of Texas resides in the Fifth Circuit, which provides that, for a moving party to dismiss a bankruptcy case, the party must make a "prima facie showing of a lack of good faith," viewing the evidence in light of the "totality of the circumstances."[171] The court found a prima facie showing of a lack of good faith because the organization attempted to avoid New York regulatory oversight and gain an unfair litigation advantage over New York.[172]

Not only did the court find bad faith due to an attempt at gaining an unfair litigation advantage, but it also found that the organization was financially solvent and that Chapter 11 would not address any "going concern."[173] The court inquired into the NRA's motivation for filing the petition and examined the NRA's public statements and testimony.[174] The court first found the NRA was "not financially underwater; [in January 2021] it reported having assets roughly $50 million greater than its debts."[175] Mr. LaPierre had testified that notwithstanding the approval of the reorganization plan, the NRA would be able to pay all of its creditors and meet its obligations.[176] Second, the court found that throughout the trial, Mr. LaPierre admitted the bankruptcy was a way of evading New York's regulatory action, and that he was not filing for bankruptcy due to financial concerns.[177] Lastly, "the Court highlighted its concerns about the lack of internal deliberation within the NRA before the filing and the executive power vested in Mr. LaPierre."[178] The court found it suspect that LaPierre decided to file for bankruptcy without informing the

165. *See* Press Release, Attorney General James Files Lawsuit to Dissolve NRA, *supra* note 15.
166. Mak, *supra* note 16.
167. *In re* Nat'l Rifl Ass'n of Am., 628 B.R. 262, 262 (Bankr. N.D. Tex. 2021).
168. Hakim & Walsh, *supra* note 157.
169. Mak, *supra* note 16.
170. Priya Baranpuria, *Northern District of Texas Bankruptcy Court Dismisses NRA Bankruptcy Cases*, JD SUPRA (July 19, 2021), https://www.jdsupra.com/legalnews/northern-district-of-texas-bankruptcy-4547801. *See* Press Release, Attorney General James Files Lawsuit to Dissolve NRA, *supra* note 16.
171. *Texas Bankruptcy Court Dismisses the NRA's Chapter 11 Filing for Lack of Good Faith*, CLEARLY GOTTLIEB (May 18, 2021), https://www.clearygottlieb.com/news-and-insights/publication-listing/texas-bankruptcy-court-dismisses-the-nras-chapter-11-filing-for-lack-of-good-faith.
172. *Id.*
173. *In re* Nat'l Rifl Ass'n of Am., 628 B.R. 262, 264 (Bankr. N.D. Tex. 2021).
174. CLEARLY GOTTLIEB, *supra* note 171.
175. Hakim & Walsh, *supra* note 157.
176. Baranpuria, *supra* note 170.
177. *See* Press Release, Attorney General James Files Lawsuit to Dissolve NRA, *supra* note 15.
178. CLEARLY GOTTLIEB, *supra* note 171.

board of directors.[179] The court concluded the plan was not filed in good faith and ordered the case dismissed.[180]

Although the reorganization plan was ultimately rejected by the court, the instant case highlights the evident weaknesses that the Code may hold regarding a financially solvent company, voluntary filing for reorganization in bad faith. The fact this strategy was an option for the NRA to pursue in order to evade state regulation is concerning. The NRA ruling "underscores the importance of clearly articulating valid bankruptcy purposes when commencing a Chapter 11 case" and emphasizes the duty of the judiciary to thoroughly analyze any bankruptcy filing for attempts to evade the exercise of a state's police power.[181]

V. REFORM: NON-DEBTOR RELEASE FORMS, THE INSOLVENCY CONSIDERATION, AND GOOD FAITH REFORM

This section will explore the potential reforms that can be made to reorganization procedures through congressional action and the imposition of a heightened standard of judicial scrutiny.

A. The Non-Debtor Release Prohibition Act of 2021: Non-Debtor Release Reform

In response to the settlement of Purdue's reorganization plan, Congressional Democrats introduced a bill that would prohibit the use of non-debtor releases.[182] In July 2021, the House Committee on the Judiciary Subcommittee on Antitrust, Commercial and Administrative Law proposed the "Non-Debtor Release Prohibition Act of 2021," ("NRPA") which would practically eliminate the use of such releases.[183]

The NRPA would incorporate § 113 into the Code, proscribing that a court will not "be permitted to discharge, release, terminate or modify a third-party's claim or cause of action against a non-debtor, whether pursuant to a plan or otherwise."[184] Specifically, the NRPA would: (a) prohibit company officers and directors from obtaining non-debtor releases in their company's reorganization plans; (b) limit to 90 days the duration of injunctions that tend to "preclude the initiation or continuation of lawsuits against non-debtors"; and (c) permit a court to dismiss a Chapter 11 case that was initiated through a divisive merger (i.e., the "Texas Two-Step") within 10 years of filing a petition.[185]

Several individuals gave testimony before the Committee on how non-debtor releases "could negatively impact tort claimants who are victims of egregious acts."[186] Tasha Schwikert Moser, an Olympic gymnast "who was among those

179. Hakim, *supra* note 14.
180. Baranpuria, *supra* note 170.
181. CLEARLY GOTTLIEB, *supra* note 171.
182. Phil Helsel, *States Vow to Fight Purdue Pharma Bankruptcy Plan That Shields Sacklers from Opioid Lawsuits,* NBC NEWS (Sept. 1, 2021, 4:32 PM), https://www.nbcnews.com/news/us-news/judge-will-approve-purdue-pharma-bankruptcy-shields-sacklers-opioid-lawsuits-n1278319.
183. Arendsen & Morrison, *supra* note 64.
184. *Id.*
185. *Id.*
186. *Id.*

sexually abused by former USA Gymnastics doctor Larry Nassar, testified during Wednesday's hearing against third-party releases as well." [187] Moser testified that "through the USA Gymnastics' bankruptcy, which began in 2018 to deal with hundreds of lawsuits related to Nassar's abuse, she was prevented from suing the U.S. Olympic Committee for its failure to protect her from Nassar, even though the committee itself was not in bankruptcy."[188]

Supporters of a prohibition on non-debtor release forms argue that the releases "violate the due process rights of abuse claimants and are not authorized under the bankruptcy code."[189] In fact, the District Court in Purdue's case found the issuance of third-party releases without the consent of the claimant violates an individual's due process rights.[190] The lower court had ruled that such releases do not violate an individual's due process rights, because the release of a claim does not finally determine that claim.[191] The District Court judge rejected that argument, providing that release of a claim extinguishes future, the alternative resolve of the claim, "so that it cannot be adjudicated on the merits."[192] The District Court further reasoned that "a third-party release has 'the effect of a judgment–a judgment against the claimant and in favor of the non-debtor, accomplished without due process'… [t]he fact that the releases are being ordered in the overall context of a plan confirmation that 'settles' many disputed matters… does not alter this."[193] Acknowledging non-debtor releases as a violation of due process rights "preserves the ability of injured claimants… to have their own 'day in court' against the non-debtor parties to try to obtain higher recoveries than they might have received under a bankruptcy plan funded… by contributions from the same parties."[194]

The time for Congress to act is now, as bankruptcy courts are split on the issue of the permissibility of non-debtor releases. However, "Congress should be careful to not throw out the baby with the bathwater."[195] The legislature should proceed with caution and "be able to avail themselves of the flexible tools required to accomplish a successful reorganization, with the bankruptcy court serving as a gatekeeper protecting all interests at play."[196] The goal is not to eliminate the benefits that reorganization provides a debtor—flexibility, efficiency, and fairness.

Yet, the bill does not exclusively cover the prohibition of non-debtor release forms, it is also expansive in its approach to bankruptcy reform. The NRPA would prohibit courts from applying the automatic stay for greater than 90 days, greatly

187. Maria Chutchian, *Bankruptcy Reform Debate Targets Bad Corporate Actors, Popular Judges*, REUTERS (July 28, 2021, 5:48 PM), https://www.reuters.com/legal/transactional/bankruptcy-reform-debate-targets-bad-corporate-actors-popular-judges-2021-07-28.
188. *Id.*
189. Randall Chase, *Closing Arguments Begin in Boy Scouts Bankruptcy Case,* CLAIMS J. (Apr. 8, 2022), https://www.claimsjournal.com/news/national/2022/04/08/309781.htm.
190. *In re* Purdue Pharm, L.P., 635 B.R. 26, 78–79 (S.D.N.Y 2021).
191. *Id.* at 73–74.
192. *Id.* at 82.
193. *Id.*
194. Steven E. Ostrow, *District Court Overturns Purdue Pharma's Chapter 11 Plan and Related Releases of Sackler Family from Opioid Liability Claims*, 18 PRATT'S J. OF BANKR. L. 61, 63 (2022).
195. Shmuel Vasser, *New Bill Would End the 'Texas Two-Step' and Eliminate Non-Debtor Releases in Chapter 11,* JD SUPRA (Nov. 11, 2021), https://www.jdsupra.com/legalnews/new-bill-would-end-the-texas-two-step-3111746.
196. *Id.*

limiting the ability of companies to stop looming litigation.[197] The bill provides that, "the stay order or decree shall immediately terminate and dissolve and be of no further force or effect 90 days after its issuance."[198] Furthermore, the NRPA would require a reorganization plan to be dismissed "if the debtor or a predecessor of the debtor was the subject of, or was formed or organized in connection with a divisional merger or equivalent transaction."[199] In other words, a bankruptcy court would be required to dismiss a case if the entity in question was created through a divisional merger. Such a bill would "effectively [end] the so-called 'Texas Two-Step.'"[200]

The NRPA would change the game for Chapter 11 bankruptcy proceedings, effectively limiting malicious ways in which companies have used its judicial system. A complete prohibition of non-debtor releases, limitation of the automatic stay, and dismissal of cases subject to a divisional merger are the core solutions in addressing bankruptcy misuse. The ills of modern Chapter 11 are clear, and congressional action is needed to prevent abuse.

B. The Bankruptcy Venue Reform Act of 2021: Venue Reform and the Elimination of the "Texas Two-Step"

Congress recently proposed the "Bankruptcy Venue Reform Act of 2021," which would change venue requirements when corporate debtors file for Chapter 11.[201] The Act would largely prevent companies from utilizing the "Texas Two-Step" by attacking the second step of the technique: Using the new subsidiary in Texas to file for bankruptcy.[202] Not only would the Act further restrict a company's ability to stop pending litigation, but it would prevent the company from forum shopping bankruptcy courts to express its grievances to a favorable federal district or judge.[203]

Currently, 28 U.S.C. § 1408 governs venue for bankruptcy cases, which provides that a bankruptcy petition may proceed in the district court for the district (a) "in which the domicile, residence, principal place of business… or principal assets" has been located during the majority of the preceding 180 days; or (b) "in which there is pending a case under Title 11 concerning such person's affiliate, general partner, or partnership."[204]

As is apparent, companies have a vast array of venue options when deciding where to file for bankruptcy. Consequently, they have been empowered to forum shop based on favorable case law in jurisdictions that are generally sympathetic debtors.[205] Oftentimes, these considerations lead to filing in Delaware, the Southern Districts of New York and Texas, or the Eastern District of Virginia, which has

197. *Id.*
198. Non-Debtor Release Prohibition Act of 2021, S. 2497, 117th Cong. § 3 (2021).
199. *Id.* at § 4.
200. *See* Vasser, *supra* note, 195
201. Bankruptcy Venue Reform Act of 2021, S. 2827, 117th Cong. § 1408(b)(2) (2021).
202. *Id.* at § 1408(b).
203. *Id.*
204. 28 U.S.C § 1408.
205. Mark A. Salzberg & Kyle F. Arendsen, *Bankruptcy Venue "Reform" – What Are the Odds This Time?,* NAT'L L. REV. (Oct. 5, 2021), https://www.natlawreview.com/article/bankruptcy-venue-reform-what-are-odds-time.

resulted "in a concentration of bankruptcy filings, especially by large public companies, in those jurisdictions."[206]

Yet, concerns one may have with the venue requirements set forth in § 1408 have not gone unnoticed in Congress, at least by some. In 2018, Senator John Cornyn, a Republican from Texas, and Senator Elizabeth Warren, a Democrat from Massachusetts, proposed the "Bankruptcy Venue Reform Act of 2018," ("2018 Venue Act") which would amend § 1408 venue requirements for entities that file for bankruptcy.[207] The 2018 Venue Act would require corporate debtors to file for bankruptcy in the district "in which the principals' assets or principal place of business in the United States," has been located for 180 days prior to proceedings.[208] The aspiration was short-lived and ultimately failed in Congress.[209]

However, in mid-2021, Representative Zoe Lofgren, a Democrat from California, and Representative Ken Buck, a Republican from Texas, introduced the "Bankruptcy Venue Reform Act of 2021."[210] Additionally, Senators Warren and Cornyn introduced a similar bill in the Senate, also called the "Bankruptcy Venue Reform Act of 2021" (together the "2021 Venue Acts").[211] Both bills slightly deviate from the 2018 Venue Act, imposing more stringent requirements in determining the proper venue. The 2021 Venue Acts would not only require a corporate debtor to file in the district where its principal place of business is located but would also require the debtor to establish, by clear and convincing evidence, that the chosen venue is proper.[212] If either of the 2021 Venue Acts are passed, "a debtor would not be permitted to commence a [C]hapter 11 case in a district-based solely on its domicile or a pending case being commenced in a district by an affiliate of the debtor unless the affiliate is the debtor's controlling shareholder."[213]

Unfortunately, the passage of the 2021 Venue Acts seem a distant dream, similar to the prior efforts in reforming venue requirements.[214] This halt in congressional action is mainly due to slim support for the bills.[215] Yet, even if the 2021 Venue Act was passed by the House and Senate, "it is unclear whether President Biden would sign the bill into law.[216] After all, President Biden is a former Senator from Delaware, a major beneficiary of the current venue rules, and was a strong proponent of the present venue statute."[217]

Nevertheless, all is not lost in the fight for bankruptcy venue reform and the elimination of the "Texas Two-Step." In February 2022, the Senate Subcommittee on Federal Courts, Oversight, Agency Action, and Federal Rights held a hearing

206. *Id.*
207. Bankruptcy Venue Reform Act of 2018, S. 2282, 115th Cong. §1408(b)(2) (2018); Salzberg & Arendsen, *supra* note 205.
208. S. 2282.
209. Salzberg & Arendsen, *supra* note 205
210. *Id.*
211. *Id.*
212. *Id.*
213. *Will We Have New Rules for Corporate Bankruptcies? Recently Proposed Legislation That Could Reform Chapter 11 Practice,* WEIL RESTRUCTURING (Mar. 11, 2022), https://restructuring.weil.com/third-party-claims/will-we-have-new-rules-for-corporate-bankruptcies-recently-proposed-legislation-that-could-reform-chapter-11-practice.
214. Salzberg & Arendsen, *supra* note 205.
215. *Id.*
216. *Id.*
217. *Id.*

that addressed corporate use of the technique.[218] Proponents of reform alleged that the "Texas Two-Step" affords corporations "the benefits of bankruptcy without [its] burdens."[219] Opponents argued that bad faith dismissal and fraudulent transfer laws are sufficient safeguards against abuse of the bankruptcy system.[220]

However, "courts are generally reluctant to dismiss a case for bad faith… [and] fraudulent transfer law's usefulness is also uncertain because the Texas state law treats the divisive merger transaction as though no transfer has occurred."[221] In support of the "Texas Two-Step" elimination, proponent witnesses pointed to Johnson & Johnson's use of the "Texas Two-Step," citing corporate abuse.[222]

Bankruptcy venue reform and the elimination of the "Texas Two-Step" are necessary milestones that must be accomplished to prevent corporate abuse as we currently see it in the bankruptcy system. Not only do the procedural failings of reorganization permit forum shopping, but they also embolden companies to temporarily halt mass tort litigation. Such weaponization of the Code was simply not envisioned by the Act of 1898, and hardly carries out its intent or purpose.

C. Solvency and Good Faith Reform

The Code's permissiveness towards a financially solvent corporation that files for reorganization is essentially the entire premise of Chapter 11. Such a principle is based on preemption: allowing a solvent company to file for reorganization to avoid *future* insolvency. As such, this article need not try and dispense with the contention that a company need be financially insolvent. Admittedly, reorganization by solvent corporations has proved beneficial for not only the entity but the economy as a whole.[223]

Nevertheless, there have been a few, divisive instances where bankruptcy law has provided companies with "easy outs." The lack of reformed solvency requirements has given companies substantial discretion in deciding under what circumstances to file for reorganization, giving the company the opportunity to, "almost at will… escape from most any undesirable financial obligations."[224] Moreover, "beneficiaries of reorganization efforts… have great incentives to participate in the bankruptcy case and… make their interests known to the judge."[225]

In order to prevent the sorts of filings seen by the NRA and Johns-Manville, there must be legislative reform into how, and under what circumstances, a solvent business entity may file for reorganization, along with an explicit, clear, directed insertion of a "good faith" requirement in *filing* for reorganization.

Under this proposed solution, the Code would proscribe the necessary minimum requirements concerning insolvency and good faith filings. In order for a company to file for reorganization in good faith, it should be shown that the company is

218. Ricketts & Lee, *supra* note 139, at 1.
219. *Id.* at 2.
220. *Id.* at 3.
221. *Id.* at 2.
222. *Id.* at 1.
223. Edmund L. Andrews, *Chapter 7 vs. Chapter 11: What's Best for the Surrounding Community?*, SIEPER (May 14, 2019), https://siepr.stanford.edu/news/chapter-7-vs-chapter-11-whats-best-surrounding-community.
224. Sheppard, *supra* note 34, at 183.
225. Zywicki, *supra* note 89.

threatened with likely, foreseeable financial harm. After this general proposition, it must be shown that the company has made the reorganization filing in good faith.

Congressional action that proscribes "solvency" and "good faith" into the Code is necessary to prevent the inconsistencies that have resulted from judicial oversight. For example, in early 2022, the Boy Scouts of America's Chapter 11 case was heard by a Delaware bankruptcy judge, following a three-week trial.[226] If the judge approves of the reorganization plan, "it would compensate tens of thousands of men who say they were sexually abused as children in Scouting, while allowing the Boy Scouts to continue as an ongoing enterprise."[227] In return for the monetary payments, certain members of the Boy Scouts of America would be released from all civil tort liability.[228]

Yet, the main issue at oral arguments became whether the plan was filed in good faith because the court had a difficult time determining how good faith played in role in determining an "equitable" remedy.[229] Specifically, the judge stated, "there's no good way to resolve 82,000 claims… but what is this trust supposed to do… and why do I have to find that it's consistent, or fair, or equitable?"[230] The judge further provided, "I don't know that any one of the settlements that the debtors entered into prepetition were fair… I have no facts to make a finding like that."[231]

Consequently, the concerns, in this case, evidence the judiciary's need for congressional guidance in determining good faith and insolvency. The explicit mention of good faith and solvency requirements in the Code seeks not to restrict the flexibility that Chapter 11 aims to provide, but rather seeks to prevent targeted misuse of the judicial system.

VI. CONCLUSION

Chapter 11 is a necessary and helpful tool that holds a seat in bankruptcy law. Reorganization affords a company, especially small businesses, a second chance—a chance to try again.[232] Chapter 11 also provides debtors with emergency relief for operations and allows them to obtain loans at a discounted rate.[233] However, in the few, impactful cases, reorganization has provided some of the country's largest economic players with a shield, allowing them to avoid financial and legal accountability, particularly in mass tort litigation.

The Sackler family used reorganization to obtain an inequitable advantage, one that a party would not have afforded otherwise. For nearly 20 years, Purdue and the Sacklers combatively marketed its opioid product, while at the same time claiming

226. *In re* Boy Scouts of Am. 642 B.R. 504, 504 (Bankr. D. Del. 2022).
227. Chase, *supra* note 189.
228. *Boy Scouts of Am.*, 642 B.R. at 586–88.
229. *See id.* at 563–64, 645–46.
230. Randall Chase, *Closing Arguments Begin in Boy Scouts Bankruptcy Case*, INS. J. (Apr. 11, 2022), https://www.insurancejournal.com/news/national/2022/04/11/662343.htm.
231. Associated Press, *Closing Arguments Begin in Boy Scouts Bankruptcy Case*, US NEWS (Apr. 6, 2022, 8:05 PM), https://www.usnews.com/news/us/articles/2022-04-06/closing-arguments-begin-in-boy-scouts-bankruptcy-case.
232. *6 Benefits of Chapter 11 Bankruptcy for Business,* SASSER L. FIRM, https://www.sasserbankruptcy.com/business-bankruptcy/chapter-11/benefits (last visited Oct. 25, 2022).
233. *Id.*

that the drug was "less than 1% addictive."[234] Purdue's soaring revenues throughout this period provided the Sacklers with close to $13 billion.[235] Meanwhile, nearly 200,000 Americans had died.[236] The result of Purdue's reorganization plan has so far proved unfortunate, and the bestowal of immunity upon the family raises legitimate concerns to the Code.

Non-debtor release forms, the power of the automatic stay, the "Texas Two-Step," and the lack of "good faith" and "solvency" requirements in the Code all call for reform to enjoin corporations from using reorganization as an alternative means to a legal and financial dispute.

234. Joseph Detrano, *The Four-Sentence Letter behind the Rise of OxyContin,* RUTGERS CTR. OF ALCOHOL & SUBSTANCE ABUSE STUDS., https://alcoholstudies.rutgers.edu/the-four-sentence-letter-behind-the-rise-of-OxyContin (last visited Oct. 25, 2022).
235. Hopkins & Scurria, *supra* note 10.
236. BBC NEWS, *supra* note 6.