Clients&FriendsMemo

Johnson & Johnson's "Red River" Bankruptcy Strategy Sinks on Third-Party Release Issues, Voting Irregularities—With Possible Implications for Future Mass Tort Bankruptcy Cases

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Introduction

On March 31, 2025, Judge Christopher Lopez of the U.S. Bankruptcy Court for the Southern District of Texas denied confirmation of the prepackaged Chapter 11 plan of Johnson & Johnson ("J&J") affiliate Red River Talc LLC ("Red River") and dismissed for "cause" Red River's Chapter 11 case. Most notably, Judge Lopez rejected Red River's argument that the plan qualified for a "full pay" exception to the prohibition on nonconsensual third-party releases established by the Supreme Court in its *Purdue Pharma* decision last year. This ruling suggests that *Purdue Pharma*'s limitations on non-debtor releases may prove difficult to evade, significantly limiting the ability of a corporate parent, like J&J, to resolve its own mass tort liabilities by putting a subsidiary through bankruptcy. *In re Red River Talc LLC*, No. 24-90505, 2025 WL 1029302 (Bankr. S.D. Tex. March 31, 2025).

Background

Red River represented J&J's third attempt to resolve its litigation liabilities related to injuries allegedly springing from the use of talcum powder.

Beginning around 2013, thousands of users of J&J's talc products started filing lawsuits against J&J, alleging that these products contained cancer-causing asbestos. To address the litigation liability, in 2021, J&J undertook a "Texas two-step" transaction, in which a parent company uses a Texas "divisional merger" statute to create a new subsidiary to hold a portion of the corporate family's tort liabilities. This type of "divisional merger" allows the new subsidiary to resolve the separated liabilities through a bankruptcy filing while the rest of the corporate family remains outside of bankruptcy.

J&J filed two previous "Texas two-step" bankruptcy cases in an effort to resolve these liabilities. Both prior cases were dismissed as bad-faith filings after the U.S. Court of Appeals for the Third

Circuit ruled in the first case that the newly-formed subsidiary lacked the requisite financial distress to be a debtor in bankruptcy, and the Bankruptcy Court then applied that ruling to dismiss the second case. In each case, the debtors also sought to release the non-debtor J&J entities from any liability for the relevant claims.

Subsequently, J&J formed a new subsidiary called Red River Talc LLC to hold only J&J's talc liabilities relating to ovarian and other gynecological cancers. Shortly after its formation, Red River filed for Chapter 11 in the U.S. Bankruptcy Court for the Southern District of Texas. Red River sought confirmation of a "prepackaged" bankruptcy plan that aimed to resolve more than 90,000 cancer claims by creating a $9 billion trust fund to settle and pay such claims.

Red River's plan relied on Section 524(g) of the Bankruptcy Code, which permits (i) formation of a trust to assume a debtor's liabilities with respect to asbestos-related claims and (ii) entry of a "channeling" injunction requiring asbestos-related claims to be asserted against only that trust. For a plan providing for such a trust and channeling injunction to be confirmed, Section 524(g) requires an affirmative vote by 75% of the relevant claimants in favor of the plan.

Bankruptcy Court Ruling

Following a two-week trial, Judge Lopez denied confirmation of Red River's plan and dismissed Red River's Chapter 11 case. Judge Lopez found the Red River plan unconfirmable for three key reasons.

Voting and solicitation irregularities

First, the Court found that it could not confirm the plan because certain defects in the prepetition solicitation and voting process prevented the debtor from achieving "the requisite 75% claimant support" necessary for a plan to be confirmed under Section 524(g). For example, thousands of claimants received an "unreasonably short" voting window; several plaintiffs' law firms cast votes on behalf of their purported clients without direct client authorization or a power of attorney; and in one instance, thousands of votes against the plan were switched to votes in favor of the plan in a manner that did not comply with the tabulation procedures set forth in the solicitation materials. Based on these irregularities, the Court held that "the entire vote cannot be certified," with the result that the "Court cannot find that the class of talc claimants voted to accept the plan."

Overbroad channeling injunctions

Second, the Court ruled that the plan's proposed "channeling" injunction was overbroad. The Court explained that a Section 524(g) channeling injunction may be used only to enjoin actions against third parties that are "derivative of claims against the debtor," with "derivative" in this context meaning that the "liability of the third party must essentially be a claim against the debtor." However, the "channeling" injunction in Red River's plan shielded over 700 non-debtor entities for potential liabilities "wholly separate" from Red River's acts and not dependent on Red River's liability. Because the testimony and argument at trial established that the plan would not work without the inclusion of these non-debtor parties within the channeling injunction, the Court concluded that the plan was not feasible and therefore could not be confirmed.

Impermissible nonconsensual releases

Third, Judge Lopez denied confirmation because the plan contained impermissible nonconsensual non-debtor releases in violation of the Supreme Court's recent decision in *Harrington v. Purdue Pharma, L.P.*, 603 U.S. 204, 207 (2024). In *Purdue Pharma*, the Supreme Court held that the Bankruptcy Code does not "authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a non-debtor without the consent of affected claimants." In Red River's case, however, Section 11.2.2 of the plan improperly sought to release claims against hundreds of non-debtor third parties related to J&J.

Red River argued that *Purdue Pharma* did not apply because its plan was a "full pay" plan that "provides for the full satisfaction" of the claims released under the plan. In support of this argument, Red River cited to a passage in the *Purdue Pharma* decision in which the Supreme Court observed that it was not "express[ing] a view on what qualifies as a consensual release or pass[ing] upon a plan that provides for the full satisfaction of claims against a third-party nondebtor[.]" Red River argued that this language suggested that otherwise prohibited non-consensual third-party releases might be permissible in a "full pay" plan that provided payment in full of releasing parties' claims.

Judge Lopez rejected this argument for two reasons. First, the Court found that "this is not a 'full pay' case," because a verdict had been entered against J&J that exceeded the proposed payout under the plan. Second, leaving aside the Supreme Court's *Purdue Pharma* decision, the U.S. Court of Appeals for the Fifth Circuit has stated "many times that nonconsensual third-party releases are not permissible." Judge Lopez declined to create a "full pay" exception to this well-settled Fifth Circuit rule.

Dismissal of Chapter 11 case for "cause"

The deficiencies described above led the Court to conclude that "cause" for dismissal existed under Bankruptcy Code section 1112(b)(1), which requires the Court to either dismiss or convert a case to Chapter 7 for a showing of "cause." Under applicable Fifth Circuit precedent, "cause" includes a lack of good faith in filing a Chapter 11 case. The Court focused on the voting irregularities as evidence of the debtor's lack of good faith. The Court also found it relevant that Red River was not an operating company, meaning that there was "no real company" and there were no "jobs to save." Furthermore, the Court cited the plan's impermissible third-party release and overbroad channeling injunction as factors that weighed in favor of dismissal.

Takeaways

- Judge Lopez's ruling casts further doubt on the future viability of the "Texas two-step" and similar strategies for resolving mass tort liabilities. J&J has now tried the strategy three times in multiple courts and failed at each turn.
- The Supreme Court's *Purdue Pharma* ruling casts doubt on whether the "Texas two-step" strategy would even offer the relief J&J and other parents might seek. Typically, a parent would seek a release of its own liabilities through a third-party release contained in the subsidiary's bankruptcy plan. *Purdue Pharma* placed a prohibition on such non-consensual non-debtor releases. The *Red River* court rejected a potential "full pay" exception to that prohibition, thereby further narrowing the options for parents to curtail their liability through a subsidiary bankruptcy.
- Notably, the *Red River* court's rejection of the "full pay" plan exception was somewhat fact-dependent. Here, the facts demonstrated that J&J faced a verdict that exceeded the proposed "full" payment under the plan. Additionally, the Court found "a difference between a claim for liquidated damages under a contract, where the damages may be calculated from the contract alone, and estimated damages based on previous settlements." The Court left the door open to recognizing a "full pay" exception to *Purdue Pharma* in a case involving, *e.g.*, contractual liquidated damages, or where it is otherwise possible to establish reliably and objectively that the plan does in fact pay all claims in full.
- Parties should look to jurisdictions outside the Fifth Circuit for success with a "full pay" exception, given the Fifth Circuit's own, separate prohibition on and seeming aversion to nonconsensual third-party releases.
- As for the implications for the J&J talc claimants themselves, Judge Lopez expressed optimism that the parties can ultimately reach some sort of "finality" on their talc claims and alluded to the potential for an out-of-court settlement.
- Shortly after the ruling, J&J announced that the company "will return to the tort system" rather than pursue a "protracted appeal."

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