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“BAD FAITH” BANKRUPTCY DISMISSALS IN THE WAKE OF LTL MANAGEMENT: RECENT DEVELOPMENTS

In 2023, the Third Circuit Court of Appeals made headlines by dismissing a Chapter 11 bankruptcy filing by a Johnson & Johnson subsidiary, LTL Management, LLC, on “bad faith” grounds. The LTL Management decision helped to provide some clarity around the traditionally poorly defined “bad faith” filing doctrine by holding that, at a minimum, a bankruptcy petition must be dismissed on “bad faith” grounds if the debtor is not “financially distressed.” However, the LTL Management decision also raised many new questions. Will courts outside the Third Circuit adopt the Third Circuit’s “financial distress” requirement? Is it possible for corporate parents to artificially “manufacture” the required “financial distress”? Is mere “financial distress” actually distinguishable from true insolvency? And how does the Third Circuit’s “bad faith” dismissal standard differ from the Fourth Circuit’s standard, which requires “objective futility” as a prerequisite for a “bad faith” dismissal? This article discusses important cases decided in the wake of LTL Management that have started to answer some of these questions.

By Casey Servais *

Few doctrines in bankruptcy law have as long a pedigree, but as diffuse a definition, as the doctrine that a bankruptcy case must be dismissed if not filed in “good faith.” This doctrine has its origins partially in the Bankruptcy Act of 1898, which remained in effect in various iterations until the enactment of the modern Bankruptcy Code in 1978, and which at various times included express statutory requirements that a debtor file a bankruptcy petition in “good faith.”¹ The modern

Bankruptcy Code dispenses with any mention of “good faith” as an express requirement for filing a bankruptcy petition or “bad faith” as an express grounds for dismissing a bankruptcy case, but courts have nonetheless continued to rely on “bad faith” or lack of “good faith” as a grounds for dismissal. Despite this long history and the resulting extensive case law, however, courts continue to struggle to give clear parameters to the “bad faith” filing doctrine, instead often emphasizing that “bad faith” is a “fact-intensive” issue that must be assessed based on the “totality of the circumstances.”

In 2023, the Third Circuit Court of Appeals made headlines by dismissing a Chapter 11 bankruptcy filing by a Johnson & Johnson subsidiary, LTL Management,

¹ For an analysis of the pre-Bankruptcy-Code “bad faith” doctrine, including both the statutory context and the most relevant pre-Code decisional law, *see, e.g., In re The Bible Speaks*, 65 B.R. 415, 420–22 (Bankr. D. Mass. 1986) and in *In re Victory Constr. Co., Inc.* 9 B.R. 549, 552–54, 568–69, *modified on other grounds*, 9 B.R. 570 (Bankr. C.D. Cal. 1981), *vacated as moot*, 37 B.R. 222 (BAP 9th Cir. 1984).

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LLC, on “bad faith” grounds. *In re LTL Mgmt., LLC*, 64 F.4th 84 (3d Cir. 2023). In that decision, the Third Circuit also seemed to provide at least one clear guidepost for the application of the “bad faith” doctrine: A bankruptcy petition is filed in “bad faith,” and must be dismissed, if the debtor is not “financially distressed.” Despite its seeming clarity on this point, the 2023 *LTL Management* decision raised many difficult new questions. Will courts outside the Third Circuit adopt the “financial distress” requirement that the Third Circuit imposed as a component of “good faith?” Is it possible for corporate parents to simply manufacture the required “financial distress” by creating new subsidiaries whose assets do not, or only barely, exceed their liabilities? Is mere “financial distress” actually distinguishable from true insolvency? And how does the Third Circuit’s clear “financial distress” requirement differ from, and interact with, the Fourth Circuit’s equally clear holding that a bankruptcy petition may be dismissed on “bad faith” grounds only if the debtor is so financially distressed that any reorganization is “objectively futile?”

In the three years since the Third Circuit decided *LTL Management*, a series of cases have begun to provide initial answers to some of these questions. This article discusses some of the most important of those cases. Ultimately, however, it may take years or decades for the implications of *LTL Management*’s “financial distress” requirement to work themselves out in the case law, and it may not be possible to achieve any true or lasting clarity around the “bad faith” filing doctrine without an intervention by the United States Supreme Court.

BACKGROUND: “BAD FAITH” AS “CAUSE” FOR DISMISSAL UNDER CHAPTER 11

As a starting point for understanding the recent evolution of the “bad faith” doctrine, it is helpful to understand first how the “bad faith” concept even fits into the statutory framework of Chapter 11 of the Bankruptcy Code. The provision of Chapter 11 that provides for dismissal of a Chapter 11 case is section 1112(b)(1), but that section does not mention bad faith.

It simply says that the court “shall” dismiss a case “for cause.”²

Another subsection of 1112, 1112(b)(4), then provides a *partial* definition of “cause” by enumerating 16 examples. The enumerated examples of “cause” include various forms of mismanagement or dissipation of estate assets,³ as well as various failures to follow procedures *within the bankruptcy case itself*.⁴

Conspicuously absent from section 1112(b)(4)’s fairly extensive list of forms of “cause” is any mention of “bad faith.” However, the drafting of section 1112(b)(4) makes clear that this list is non-exclusive, because the statute merely states that the term “cause” *includes* the enumerated examples. This non-exclusive nature of section 1112(b)(4) gives courts an opening to also consider “bad faith” or lack of “good faith” as a form of “cause” for dismissal.⁵

Assuming, then, that “bad faith” can constitute an unenumerated form of “cause,” the question becomes:

² 11 U.S.C. § 1112(b)(1) (“[O]n request of a party in interest, and after notice and a hearing, *the court shall* convert a case under this chapter to a case under chapter 7 or *dismiss a case under this chapter*, whichever is in the best interests of creditors and the estate, *for cause* unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.”) (emphasis added).

³ See, e.g., 11 U.S.C. § 1112(b)(4)(A) (defining “cause” to include “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation”) or § 1112(b)(4)(B) (defining “cause” to include “gross mismanagement of the estate”).

⁴ See, e.g., 11 U.S.C. § 1112(b)(4)(E) (defining “cause” to include “failure to comply with an order of the court”) or § 1112(b)(4)(F) (defining “cause” to include an “unexcused failure to satisfy timely any filing or reporting requirement [within the chapter 11 case]”).

⁵ *In re LTL Mgmt., LLC*, 64 F.4th 84, 100 (3d Cir. 2023) (“A lack of good faith constitutes ‘cause,’ though it does not fall into one of the examples of cause specifically listed in the statute.”).

What *is* bad faith? Here, many courts tend to focus either on a non-exclusive list of factors indicative of “bad faith,” such as the factors identified by the Eleventh Circuit in *In re Nat. Land Corp.*, 825 F.2d 296 (11th Cir. 1987),⁶ or on a non-exclusive list of typical “bad faith” fact patterns, such as the fact patterns identified by the Fifth Circuit in *In re Little Creek Devel. Co.*, 779 F.2d 1068 (5th Cir. 1986).⁷ Leaving aside the sheer length and complexity of these lists of factors and patterns, their non-exclusive nature still leaves the “bad faith” doctrine without much definition.

Out of this near-chaos of factors and patterns, the Third Circuit in *LTL Management* helpfully honed in on “two inquiries” as being “particularly relevant”: “(1) whether the [bankruptcy] petition serves a valid bankruptcy purpose[;] and (2) whether [it] is filed merely to obtain a tactical litigation advantage.”⁸ While comparatively concise, however, the concept of a “valid bankruptcy purpose” is still quite vague. The Third Circuit, therefore, attempted to provide further definition to this concept by holding that, at a minimum, a valid

bankruptcy purpose “assumes a debtor in financial distress.”⁹

The Third Circuit’s assumption that a “valid bankruptcy purpose” exists only where a debtor is financially distressed may not *seem* like a controversial proposition, because legal practitioners and laypeople alike generally associate bankruptcy with financial distress. However, the Bankruptcy Code itself does not actually include any *express* requirement that a debtor be insolvent or otherwise financially distressed in order to file for Chapter 11.¹⁰ For that reason, the Third Circuit’s conclusion in *LTL Management* that a bankruptcy filing is in bad faith and should be dismissed if the debtor is not in financial distress is at least somewhat in tension with the express text of the Bankruptcy Code.

To understand how this “financial distress” issue arose in *LTL Management*, as well as the type of fact pattern in which it is relevant, it is helpful to examine the facts of that case.

LTL MANAGEMENT: FOREGROUNDING “FINANCIAL DISTRESS”

LTL Management was an effort by the Johnson & Johnson corporate family to resolve liabilities arising from the sale of Johnson’s Baby Powder and other products containing the mineral talc. Beginning around 2010, an increasing number of consumers started filing claims against Johnson & Johnson alleging that the talc in its products contained asbestos and caused cancer. Johnson & Johnson ultimately sought a way to address these talc claims in a manner that would not affect the rest of its operations. To accomplish this, Johnson & Johnson divided the subsidiary that had formerly sold its talc products, referred to in the case law as “Old Consumer,” into two new entities using a “good company,” “bad company” structure. This type of corporate restructuring is sometimes called a “Texas Two-Step” where, as in Johnson & Johnson’s case, the new corporate structure is created using a specific Texas divisional merger statute.¹¹

⁶ These factors include lack of a realistic possibility of an effective reorganization; the debtor seeks merely to delay or frustrate the legitimate efforts of secured creditors to enforce their rights; the debtor is seeking to use the bankruptcy provisions to create and organize a new business, not to reorganize or rehabilitate an existing enterprise; the timing of the debtor’s relevant actions; the debtor appears to be merely a “shell” corporation; or the debtor was created, or the subject property transferred to the debtor, for the sole purpose of obtaining protection under the automatic stay. *In re Nat. Land Corp.*, 825 F.2d 296, 298 (11th Cir. 1987).

⁷ These typical fact patterns include: (1) The debtor has only one asset. The secured creditors’ liens encumber this asset; (2) There are generally no employees except for the principals, little or no cash flow, and no available sources of income to sustain a plan of reorganization; (3) There are only a few, if any, unsecured creditors whose claims are relatively small; (4) The property has been posted for foreclosure because of arrearages on the debt and the debtor has been unsuccessful in defending actions against the foreclosure in state court; (5) The debtor and one creditor have proceeded to a stand-still in state court litigation, and the debtor has lost or has been required to post a bond that it cannot afford. Bankruptcy offers the only possibility of forestalling loss of the property; (6) Allegations of wrongdoing by the debtor or its principals; and (7) The “new debtor syndrome,” in which a one-asset entity has been created or revitalized on the eve of bankruptcy. *In re Little Creek Devel. Co.*, 779 F.2d 1068, 1073 (5th Cir. 1986).

⁸ *In re LTL Mgmt., LLC*, 64 F.4th 84, 101 (3d Cir. 2023).

⁹ *In re LTL Mgmt., LLC*, 64 F.4th 84, 101 (3d Cir. 2023).

¹⁰ 11 U.S.C. § 109(d) (setting forth eligibility requirements to “be a debtor under chapter 11 of [the Bankruptcy Code]”); *cf* 11 U.S.C. § 109(e) (setting forth eligibility requirements to “be a debtor under chapter 9 of [the Bankruptcy Code],” including a requirement that the debtor be “insolvent,” which is absent from the chapter 11 eligibility requirements in section 109(d)).

¹¹ V.T.C.A., Business Organizations Code § 1.002(55)(A).

Following this corporate restructuring, the “good company” — referred to in the case law as “New Consumer” — held Old Consumer’s valuable assets. The “bad company,” called LTL Management, LLC, held Old Consumer’s talc liabilities. The new “good company,” New Consumer, also entered into a “funding agreement” under which the “good company” agreed to fund the “bad company’s” talc liabilities up to the value of the “good company,” which was approximately \$61.5 billion dollars as of the date of LTL’s subsequent bankruptcy filing. Johnson & Johnson itself — the larger, ultimate parent of both the “good company” and the “bad company” — was also a party to the funding agreement, providing even more potential value from which the bad company’s talc liabilities could be paid.

LTL then filed for bankruptcy. Certain talc claimants moved to dismiss the case, including on the grounds that LTL was not in financial distress and that the bankruptcy filing therefore did not serve a legitimate bankruptcy purpose. The Third Circuit agreed with that argument and dismissed the case as a “bad faith” filing.

To reach its conclusion that LTL was not in financial distress, the Third Circuit compared LTL’s assets to its *known* liabilities. Clearly, LTL’s most important asset was its funding agreement, which allowed LTL to access up to \$61.5 billion of value from the “good company,” New Consumer, as well as potentially even more value from the highly solvent parent company, Johnson & Johnson. As against that \$61.5 billion or more of assets, LTL had known liabilities of “only” around \$3.5 billion in talc verdicts and settlements as of the bankruptcy filing, plus around \$1 billion in legal defense costs related to talc litigation. Therefore, as of the time of the bankruptcy filing, LTL’s assets appeared to vastly exceed its liabilities. Under these facts, the Third Circuit concluded that it was “hard to imagine a scenario where J&J and New Consumer would be unable to satisfy their joint obligations under the Funding Agreement.”¹²

In opposing dismissal, LTL and Johnson & Johnson argued that although LTL’s known liabilities may not have exceeded its assets at the moment of the bankruptcy filing, LTL faced thousands of additional talc claims that might eventually place it into financial distress. The Third Circuit rejected that argument on the grounds that LTL’s future financial distress remained speculative and not sufficiently “imminent.”¹³ Essentially, the Third Circuit indicated that LTL and Johnson & Johnson needed to try their luck in the tort

system a while longer. If their potential talc liabilities ultimately materialized in the form of verdicts in an amount sufficient to cause real financial distress, then the time might become ripe for a bankruptcy filing.

In this context, the Third Circuit made two somewhat nebulous distinctions that it may be a challenge for future courts to apply.

First, the Third Circuit made what it acknowledged was a very “fine” distinction between an “early” bankruptcy filing and a “premature” bankruptcy filing.¹⁴ The Third Circuit recognized that there *is* a bankruptcy policy in favor of a debtor filing “early” enough that it can actually reorganize before its business becomes a lost cause.¹⁵ However, the Third Circuit also distinguished that type of “early” filing from what it called a “premature” filing, like that of LTL. According to the Third Circuit, a “premature” filing occurs where financial distress is not yet “immediate,” and where there is only an “attenuated” possibility that the debtor may have to file for bankruptcy in the future.¹⁶ Going forward, this distinction between “premature” and “early” filings creates a potential conundrum for debtors, because they will need to make a difficult judgment call as to whether they are sufficiently financially distressed to file for bankruptcy in good faith, while at the same time not waiting so long that there is no longer any hope of successfully rehabilitating their businesses.

This tricky distinction between “premature” and “early” filings mirrors a second, equally difficult-to-apply distinction arising out of *LTL Management*, namely the distinction between “insolvency” and mere “financial distress.” The Third Circuit went out of its way to avoid saying that a debtor needs to be actually “insolvent” in order to file for bankruptcy in good faith — a requirement that would probably be indefensible as a statutory matter given the lack of an express “insolvency” requirement as an element of Chapter 11 eligibility. Instead of requiring actual “insolvency,” *LTL Management* therefore required mere “financial distress.” In making this distinction, the Third Circuit defined insolvency as either “balance-sheet insolvency,” where liabilities exceed assets on the debtor’s balance

¹² *In re LTL Mgmt., LLC*, 64 F.4th 84, 106 (3d Cir. 2023).

¹³ *In re LTL Mgmt., LLC*, 64 F.4th 84, 109 (3d Cir. 2023).

¹⁴ *In re LTL Mgmt., LLC*, 64 F.4th 84, 102 (3d Cir. 2023).

¹⁵ *In re LTL Mgmt., LLC*, 64 F.4th 84, 102 (3d Cir. 2023) (“Yet we recognize the Code contemplates ‘the need for early access to bankruptcy relief to allow a debtor to rehabilitate its business before it is faced with a hopeless situation.’”) (quoting *In re SGL Carbon Corp.*, 200 F.3d 154, 163 (3d Cir. 1999)).

¹⁶ *In re LTL Mgmt., LLC*, 64 F.4th 84, 109 (3d Cir. 2023).

sheet, or cash-flow insolvency, where the debtor has insufficient cash flows to pay its liabilities.¹⁷ By contrast, the court defined “financial distress” as “something short of insolvency,” such as where “[u]nliquidated future liabilities pose an obstacle to efficiently obtaining financing and investment;” “[f]inancial problems or litigation may require significant attention, resulting in serious managerial difficulties;” or there is an “exodus of customers and suppliers wary of a firm’s credit-risk.”¹⁸

Despite the Third Circuit’s efforts to distinguish between “insolvency” and “financial distress,” there remains a fair amount of subjectivity around the “financial distress” side of the distinction in particular, such that in practice it may be difficult to conclude that an entity is sufficiently “financially distressed” to justify a bankruptcy filing unless that entity is actually either balance-sheet or cash-flow insolvent. In jurisdictions where *LTL Management* is followed, this distinction therefore risks creating a *de facto* insolvency requirement for Chapter 11 filings, because debtors may be uncertain that they are sufficiently financially distressed to justify a bankruptcy filing unless they are actually insolvent.

SIMILAR FACTS, DIFFERENT TERMINOLOGY, SAME OUTCOME: *IN RE AEARO TECHNOLOGIES LLC*

Given that the Third Circuit’s *LTL Management* decision seems to establish a “financial distress” requirement for a “good faith” bankruptcy filing that is more stringent than in most other jurisdictions, one important question becomes whether courts outside of the Third Circuit will view *LTL Management* as persuasive and follow its reasoning. One initial answer to that question came within a few months of the Third Circuit’s 2023 *LTL Management* decision, in a case in the Bankruptcy Court for the Southern District of Indiana called *In re Aearo Techs. LLC*, 2023 WL 3938436, at *18 (Bankr. S.D. Ind. June 9, 2023). In that instance, the answer appeared to be “yes.”

Aearo had a fact pattern extremely similar to that of *LTL Management*, in that it involved tort liabilities concentrated in one subsidiary of a larger corporate family, with the relevant corporate family in *Aearo* being 3M rather than Johnson & Johnson. The main factual *difference* between *Aearo* and *LTL Management* was that in *Aearo* there was no Texas Two-Step or other divisional merger, meaning that the relevant subsidiary

holding the primary tort liabilities in the *Aearo* case was not specifically *created* to hold those liabilities and resolve them in bankruptcy. Instead, 3M acquired Aearo Technologies LLC in 2008 without being aware that Aearo would later become a major target of tort litigation. Specifically, Aearo manufactured noise-cancelling earplugs and sold them to the U.S. military, which presumably seemed like a good business at the time 3M acquired the company. After the acquisition, however, former military service members started filing lawsuits alleging that Aearo’s earplugs were defective and that they had suffered hearing loss as a result. Over time, service members filed hundreds of thousands of lawsuits against Aearo, resulting in one of the largest tort litigations in U.S. history.

To try to resolve these alleged tort liabilities, 3M caused just its Aearo-related subsidiaries to file for Chapter 11 in the Southern District of Indiana. Just as in *LTL Management*, the parent company, 3M, entered into a funding agreement under which 3M would provide funds to pay Aearo’s tort liabilities as determined in the bankruptcy process. Also as in *LTL Management*, tort claimants moved to dismiss Aearo’s bankruptcy case as a “bad faith” filing, including by arguing that Aearo was not in “financial distress” and therefore was not entitled to bankruptcy relief.

Ultimately, the practical outcome in *Aearo* was the same as in *LTL Management*: The case was dismissed as a bad faith filing. The *Aearo* court did express some discomfort with relying on lack of “financial distress” *per se* as a grounds for dismissal, however, given the Bankruptcy Code’s lack of an express insolvency requirement. The *Aearo* court therefore chose to “frame the issue in terms of a debtor’s ‘need’ [for bankruptcy protection] rather than ‘financial distress,’” even while acknowledging that, as practical matter, “the inquiry will often be the same.”¹⁹ Specifically, regardless of the terminology used, the decisive question will be “are the problems the debtor is facing within the range of difficulties envisioned by Congress when it crafted Chapter 11?”²⁰ Just as in *LTL Management*, it was the existence of a funding agreement between Aearo and its solvent corporate parent that convinced the *Aearo* court to answer this question in the negative. The *Aearo* court concluded that the case did not serve a legitimate bankruptcy purpose, because the applicable funding agreement represented an “‘uncapped and no cost’

¹⁷ *In re LTL Mgmt., LLC*, 64 F.4th 84, 102 (3d Cir. 2023).

¹⁸ *In re LTL Mgmt., LLC*, 64 F.4th 84, 102 (3d Cir. 2023).

¹⁹ *In re Aearo Techs. LLC*, 2023 WL 3938436, at *17 (Bankr. S.D. Ind. June 9, 2023).

²⁰ *In re Aearo Techs. LLC*, 2023 WL 3938436, at *17 (Bankr. S.D. Ind. June 9, 2023).

guarantee . . . that 3M will pay Aearo’s creditors in full regardless of whether Aearo is in bankruptcy.”²¹

The *Aearo* case, therefore, provides at least an initial indication that some courts outside the Third Circuit may be willing to follow *LTL Management*’s general reasoning, at least under a highly similar fact pattern. Courts outside the Third Circuit may choose not to rely as directly or expressly on the concept of “financial distress,” however, given the lack of an express “insolvency” requirement in the Bankruptcy Code.

MANUFACTURING FINANCIAL DISTRESS: LTL MANAGEMENT (AGAIN) AND BEDMAR

In both *LTL Management* and *Aearo*, the factual element that led to dismissal was the funding agreement with the debtors’ affiliates, because it was the funding agreement that prevented the debtor from being in “financial distress” (in the terminology of *LTL Management*) or from being able to demonstrate a “need” for bankruptcy relief (in the terminology of *Aearo*). This commonality raises the question: Could a corporate parent that wished to put only one of its subsidiaries into bankruptcy evade dismissal by purposefully designing the debtor subsidiary to be financially distressed, for example by providing less generous financial support to the debtor subsidiary than in the original *LTL Management* case or in *Aearo*? In other words, is it possible to evade the outcome of *LTL Management* by “manufacturing” financial distress?

Corporate parents have attempted to “manufacture” financial distress in this manner in at least two cases since the Third Circuit’s initial 2023 *LTL Management* decision. In both cases, the gambit failed, and both cases were dismissed as “bad faith” filings. Based on these initial results, “manufacturing” financial distress does not appear to be a promising strategy for evading *LTL Management*, at least when the distress is too obviously “manufactured.”

The first corporate parent to attempt to “manufacture” financial distress in response to the Third Circuit’s 2023 *LTL Management* decision was Johnson & Johnson itself. The same day the dismissal of LTL’s first bankruptcy case became effective, Johnson & Johnson caused LTL to file for bankruptcy a second time, but made a number of strategic changes in response to the dismissal of the first case. First and foremost, in place of the original funding agreement guaranteeing funding

from both New Consumer and the larger Johnson & Johnson corporation, Johnson & Johnson this time caused LTL to enter into a new funding agreement that provided for funding from New Consumer *only*. Notably, New Consumer itself had also declined in value since the filing of the first case, in part as the result of a spin-off of some of its assets. As a result, at the time of LTL’s second bankruptcy filing, New Consumer was worth only around \$30 billion in the ordinary course, or around \$22.3 billion in a worst-case forced-liquidation scenario, as compared to New Consumer’s \$61.5 billion value at the start of the first LTL case.

In view of the significantly diminished value of its funding agreement, LTL argued that it was now sufficiently “financially distressed” to file for bankruptcy in good faith. However, following an evidentiary hearing, the Bankruptcy Court for the District of New Jersey rejected that argument, concluding that in spite of this somewhat transparent effort to manufacture financial distress, LTL was still not financially distressed *enough*. Instead, based on the evidence and expert testimony presented at trial, the Bankruptcy Court concluded that LTL’s assets still exceeded its liabilities, even in a worst-case scenario. As a result, the Bankruptcy Court dismissed LTL’s second bankruptcy case as another “bad faith” filing, and the Third Circuit affirmed that dismissal.²²

More recently, a corporate parent made a similar attempt to “manufacture” financial distress in a case called *In re Bedmar, LLC*, 2025 WL 2496260 (Bankr. D. Del. Aug. 29, 2025), with equally unsuccessful results. In *Bedmar*, the debtor’s parent was a biotechnology company that expanded rapidly during the COVID-19 pandemic, leasing numerous manufacturing, laboratory, and office facilities. However, demand for the parent’s products proved to be less than anticipated, and several leased properties became underutilized and unprofitable. To address these unprofitable leases, the parent created a new debtor entity through a divisional merger — similar to a Texas Two-Step, but in this instance effectuated under Delaware law — and allocated the parent’s lease liabilities to the new debtor. The parent also allocated to

²¹ *In re Aearo Techs. LLC*, 2023 WL 3938436, at *18 (Bankr. S.D. Ind. June 9, 2023) (emphasis added).

²² *In re LTL Mgmt. LLC*, 2024 WL 3540467 (3d Cir. July 25, 2024). Johnson & Johnson subsequently attempted to resolve its talc liabilities through a third bankruptcy filing, this time in the Southern District of Texas. That case was also dismissed as a “bad faith” filing, albeit based more on irregularities in the voting process and the presence of impermissible non-consensual third-party releases in the proposed plan than based on a lack of financial distress. *In re Red River Talc LLC*, 670 B.R. 251, 305 (Bankr. S.D. Tex. 2025).

the debtor just enough assets to pay its lease liabilities as capped under section 502(b)(6) of the Bankruptcy Code, but not enough to pay the uncapped amount. The debtor then filed for bankruptcy with the goal of rejecting the unprofitable leases and paying “rejection” damages claims on the leases as capped under section 502(b)(6) of the Bankruptcy Code.

To understand what the parent was trying to accomplish in *Bedmar*, it is helpful to provide some background on section 502(b)(6) of the Bankruptcy Code. That provision caps damages claims arising from rejected leases, often resulting in a much lower damages claim by lessors than would otherwise exist outside of bankruptcy. The cap under section 502(b)(6) exists in part because commercial leases tend to have very long lease terms, meaning that rejection of such long-term leases would often result in large damages claims that could consume much of the value of the debtor’s estate and leave little in the way of a recovery for other, non-lesser creditors. The primary goal of the cap under 502(b)(6) is therefore to preserve some value for non-lesser creditors, not necessarily to benefit the debtor.

In *Bedmar*, however, there were no non-lesser creditors to benefit from the 502(b)(6) cap, because the debtor was created to hold *only* lease liabilities. As a result, the beneficiaries of the 502(b)(6) cap would be the debtor’s parent and its shareholders — who would be relieved of the onerous lease obligations they had assigned to the debtor — *not* other creditors as intended by section 502(b)(6).

Unsurprisingly, the Bankruptcy Court for the District of Delaware rejected this effort to “manufacture” financial distress and dismissed *Bedmar*’s case as a bad faith filing. The court concluded that because the debtor’s parent had artificially engineered the debtor’s financial distress, it did not satisfy the “financial distress” requirement under *LTL Management*. The court wrote that “the facts demonstrate that the Debtor’s financial condition was ‘manufactured,’ and therefore, the financial distress is not bona fide and does not meet the good faith standard.”²³

The *Bedmar* court also indicated that the filing was in bad faith for a second reason, namely that the debtor was trying to misuse section 502(b)(6) for a purpose for which that provision was not intended. According to the court, “the evidence establishes that this case was filed to take advantage of the distributional mechanism set

forth in section 502(b)(6) and limit lease rejection damages . . . so that value is preserved for the benefit of the [debtor’s parent] and its shareholders . . . Although the Bankruptcy Code contains provisions that have the effect of redistributing value from one interest group to another, this redistribution is not the Bankruptcy Code’s purpose. Here, the purpose of the Debtor’s case is to benefit the shareholders of the [debtor’s parent] — which is outside the purpose of the Bankruptcy Code and not done in good faith.”²⁴

Together with *LTL*’s second dismissed bankruptcy case, *Bedmar* therefore suggests that a strategy of trying to *artificially* manufacture financial distress is unlikely to provide a viable workaround with respect to *LTL Management*’s “financial distress” requirement, at least where such efforts to manufacture distress are too transparent and obvious, and therefore reek of bad faith.

“FINANCIAL DISTRESS” AS INSOLVENCY: AIG FINANCIAL PRODUCTS CORP.

Aearo, the second *LTL Management* case, and *Bedmar* all had the same outcome in that they were all dismissed because the debtor was found to be insufficiently financially distressed. But have there been any important cases following *LTL Management* where the financial distress requirement was found to be *satisfied*, and do those cases provide any additional clarity about what qualifies as “financial distress”?

Perhaps the most important post-*LTL Management* case to date in which sufficient financial distress was found to exist is *In re AIG Fin. Prods. Corp.*, 2024 WL 810051 (D. Del. Feb. 27, 2024). The debtor in that case, AIG Financial Products Corp., was a subsidiary of AIG that engaged in derivatives trading. The debtor sustained billions of dollars of losses as a result of the 2008-2009 financial crisis. To prevent the debtor from needing to undergo an unfavorable “fire sale” liquidation, the parent, AIG, extended financial support to the debtor in the form of what it characterized as a revolving loan for up to \$65 billion. Later, after having resolved most of its derivatives positions, the debtor filed for bankruptcy in the Bankruptcy Court for the District of Delaware.

Creditors with employment-based claims against the debtor challenged the bankruptcy as a bad faith filing on the grounds that the debtor was not really financially distressed. In this instance, the court rejected that

²³ *In re Bedmar, LLC*, 2025 WL 2496260, at *9 (Bankr. D. Del. Aug. 29, 2025).

²⁴ *In re Bedmar, LLC*, 2025 WL 2496260, at *18 (Bankr. D. Del. Aug. 29, 2025).

argument and concluded that the debtor satisfied *LTL Management*'s financial distress requirement. However, the court based that conclusion on the fact that the debtor was balance-sheet insolvent. Specifically, the debtor had a book value of only around \$315 million at the time of the bankruptcy filing, whereas it had \$37.7 billion in liabilities consisting primarily of a \$37.4 billion loan drawn on its revolving credit line from its parent.

Notably, the finding of insolvency in *AIG Financial Products Corp.* was actually something of a close call, because the creditors there did raise an argument that the "loan" from the debtor's parent should be recharacterized as an equity contribution rather than as debt. If the parent's financial support *were* in fact viewed as an equity contribution rather than a loan, then that contribution from the parent would give rise to an asset rather than a liability, likely rendering the debtor solvent and (probably) not even "financially distressed." However, the court held that the creditors seeking dismissal had expressly waived their recharacterization arguments, and it also cast doubt on the merits of those recharacterization arguments under the facts of this case. It should nonetheless be noted that any form of financial support from a parent to a subsidiary, even if nominally in the form of a loan, may be scrutinized in bankruptcy for possible recharacterization as an equity contribution, meaning that recharacterization issues like those hinted at in *AIG* could drive the "financial distress" analysis in many future cases applying *LTL Management*.

Unfortunately, *AIG Financial Products Corp.* does little to illuminate the distinction between mere "financial distress" and actual insolvency, because the debtor there *was* found to be actually insolvent. More helpful would be a case in which the debtor was found to be sufficiently financially distressed to file for bankruptcy, but *not* actually insolvent. With any luck, such a case may emerge in the near future to provide additional guidance with respect to this crucial distinction.

WHAT A DIFFERENCE A CIRCUIT MAKES: IN RE ALDRICH PUMP LLC

Finally, while the Third Circuit's *LTL Management* decision *requires* that a bankruptcy case be dismissed if the debtor is not financially distressed, it is important to note that the Fourth Circuit has its own standard for "bad faith" that can lead to precisely the opposite result.

The relevant Fourth Circuit standard was first articulated in *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989), where the Fourth Circuit held that a case can be dismissed as a bad faith filing *only* when

(1) reorganization would be "objectively futile" *and* (2) the debtor is acting in subjective bad faith in seeking bankruptcy protection. The "objective futility" prong of this standard can best be understood by reference to the facts of the *Carolin* case, which involved a debtor whose only asset was a fire-damaged industrial building. The debtor had no income from the building; the building was unrentable; and the debtor's owners were unwilling to provide funds to repair the building. The Fourth Circuit held that reorganization was "objectively futile" under those facts, meaning that there was simply no viable business to reorganize. In other words, "objective futility" under this standard means that the debtor is *too* financially distressed to reorganize.

The case of *In re Aldrich Pump LLC*, 2023 WL 9016506 (Bankr. W.D. N.C. Dec. 28, 2023), decided by a court in the Fourth Circuit within a year of the Third Circuit's 2023 *LTL Management* decision, illustrates the way in which the Fourth Circuit's test can lead to a contrary result under highly *LTL*-like facts. As the *Aldrich Pump* court itself recognized, the facts of that case "closely parallel[ed]" those of *LTL Management*.²⁵ Specifically, like *LTL* itself, the debtors in *Aldrich Pump* were "bad companies" recently formed through a Texas Two-Step to hold asbestos liabilities. Moreover, just like in *LTL Management*, those newly formed "bad company" debtors had funding agreements with the corresponding "good companies" pursuant to which the "good companies" would help to satisfy the bad companies' asbestos-related liabilities. As a result, like *LTL*, the *Aldrich Pump* debtors were "awash in disposable income dwarfing their liabilities" and were able to "avail themselves of massive net assets far beyond those liabilities."²⁶

In the Third Circuit, the *Aldrich Pump* case clearly would have been dismissed under these facts due to a lack of financial distress. In the Fourth Circuit, however, the opposite occurred. The case survived dismissal because, as the *Aldrich Pump* court explained, "financial distress is not a factor in the [Fourth Circuit's] controlling *Carolin* standard."²⁷

Indeed, in the *Aldrich Pump* court's view, a case filed by a non-financially-distressed debtor should *always*

²⁵ *In re Aldrich Pump LLC*, 2023 WL 9016506, at *25 (Dec. 28, 2023).

²⁶ *In re Aldrich Pump LLC*, 2023 WL 9016506, at *24 (Dec. 28, 2023).

²⁷ *In re Aldrich Pump LLC*, 2023 WL 9016506, at *15 (Dec. 28, 2023).

survive “bad faith” dismissal based on the “objective futility” prong of the Fourth Circuit’s *Carolin* test, because the absence of financial distress means that it is *not* “objectively futile” for the debtor to attempt to reorganize. As the *Aldrich Pump* court stated, “[b]ecause [the Fourth Circuit’s] *Carolin* [decision] involved a fatally insolvent debtor, the application of its two-prong standard to a case filed by a solvent, financially non-distressed debtor means all such cases survive dismissal, regardless of purpose.”²⁸

In addition to inviting forum shopping on the part of non-financially-distressed debtors, the fact that lack of financial distress plays nearly opposite roles in the “bad faith” analyses of the Third and Fourth Circuits demonstrates the continuing lack of clarity and uniformity in the “bad faith” dismissal doctrine — perhaps warranting intervention by the United States Supreme Court to clarify which of the two approaches other circuits should follow, and whether the “bad faith” dismissal doctrine in fact remains viable following the enactment of the Bankruptcy Code.

CONCLUSION

In a memorable turn of phrase, Judge James F. Queenan, Jr. of the Bankruptcy Court for the District of Massachusetts once derided the “good faith filing doctrine” as “an amorphous gestalt, devoid of reasoning and impenetrable to understanding.”²⁹ While few other courts have been as unrestrained in their criticisms, most would probably agree that the doctrine remains unusually ill-defined, despite its long history. The Third Circuit’s 2023 *LTL Management* decision has the potential to provide at least some shape to this doctrine by establishing “financial distress” as one essential element in any “good faith” bankruptcy filing, but the Third Circuit’s “financial distress” concept itself remains frustratingly elusive, and the case law required to fill in the contours sketched by *LTL Management* is only starting to develop. The cases discussed in this article mark only the beginning of that process, at the end of which the “good faith” filing doctrine may hopefully emerge as more than an “amorphous gestalt,” and may become increasingly susceptible to both reasoning and understanding. ■

²⁸ *In re Aldrich Pump LLC*, 2023 WL 9016506, at *27 (Dec. 28, 2023).

²⁹ *In re Victoria Ltd. P’ship*, 187 B.R. 54, 62 (Bankr. D. Mass. 1995).