The Implications of LTL's Per-Debtor Analysis

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The Third Circuit's opinion in LTL Management, LLC, has an important implication for bankruptcy cases that goes far beyond mass tort cases: the opinion's insistence on the individual debtor company as the unit of analysis.

Modern businesses are generally structured with multiple corporate entities that often act as an integrated firm. They may share information technology, corporate treasuries, human resources, and intellectual property, they are co-debtors on financial obligations, may have consolidated financials and tax returns, and they often hold themselves out to the world as unified firms. But they also use internal corporate divisions to partition assets and liabilities. Corporate partitioning facilitates the sale of operating units, but also operates as a shield against involuntary creditors.

The Bankruptcy Code, however, is written as if debtor firms are single-entity firms. Each debtor entity has to file its own petition and be independently eligible for bankruptcy. For example, a bank holding company may file for Chapter 11, but that will not make its insured depository subsidiary eligible for bankruptcy relief. The Code always refers to the "debtor" as its operative unit, and no provision of the Code other than section 524(g) expressly grants any relief to an affiliate of the debtor, whether or not that affiliate is a debtor itself in another case or a nondebtor. Instead, courts are forced to resort to section 105(a) or tendentious readings of section 362(a) to extend relief to non-debtor affiliates.

To be sure, the Code does have a definition for "affiliate," but that term is rarely used in the Code. When it is used, it rarely refers to the affiliates of the debtor. Instead, it is mainly used to expand the scope of definitions referring to non-debtor entities, such as "insiders". Beside 524(g), the only Code provisions even expressly implicating the debtor's affiliates are an exemption from securities registration offerings under a joint plan of the securities of an affiliate, and the requirement of disclosure of affiliate officers and directors if there is a joint plan.

The bankruptcy bar has jury-rigged a solution to the disconnect between the Code's single-entity drafting and the realities of multiple entity firms: cases are jointly administered, motions are jointly made, orders jointly entered, plans jointly filed, and debtors deemed consolidated for plan voting and distribution purposes. And this generally works because nobody objects in most instances because there's no obvious percentage in objecting; cases like *Owens-Corning* where there is a fight over consolidation are the exception.

But issues arising from the disconnect between the Code and corporate realities still emerge from time to time, such as the scope of evaluation of single asset real estate case status or the scope of 1129(a)(10)'s voting requirement. Should the unit of analysis be the debtor or the entire affiliated corporate group? And should it matter if some of the group are also debtors in their own cases?

The LTL opinion may have inadvertently weighed in on this morass by indicating that good faith filing analysis must be done on a per-debtor basis without reference to affiliates' financial distress. The per-debtor analysis prescribed by the opinion is particularly important because it is not an opinion tethered

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to any particular statutory text in the Code, but rather an interpretation of a judge-made doctrine that encompasses more broadly applicable principles.

Consider the implications. After LTL, it will be more difficult to justify a per-plan interpretation of section 1129(a)(10). And it will be easier for creditors to argue that SARE status is determined on a per-entity basis, so the automatic stay can be lifted under 362(d)(3) against the particular debtor entities holding single asset real estate.

LTL only addressed whether a non-debtor's financial distress could be attributed to the debtor, but it is hard to see why the same analysis would not apply when dealing with multiple affiliated debtors; nothing in the opinion depended on the fact that Johnson & Johnson was not itself in bankruptcy, only that LTL's financial distress had to be evaluated independently. Indeed, mere bankruptcy of an affiliate cannot possibly create financial distress sufficient to meeting the good faith test.

The decision has immediate implications for other cases pending in the Third Circuit, including FTX and Boy Scouts of America. The FTX bankruptcy involves several different "silos" of debtor entities, affiliated only through common ownership by Sam Bankman-Fried. The silos include both a US-based exchange silo and a Bahamas-based exchange silo. The entities in the US exchange silo are alleged to be solvent and untouched by the alleged fraud that contaminated the Bahamian exchange entities.[1] If so, under the logic of LTL, the distress of the Bahamian entities cannot be imputed to the US entities, such that the US entities' cases would be vulnerable to a good faith filing challenge. Indeed, such a challenge would seem appealing to US entities' creditors as a way to prevent the US entities' assets from being used to pay creditors of other debtor entities.

The implications reach even farther than mere good faith filing doctrine dismissal. What if the debtor entity used to establish venue has its case dismissed because it lacked independent financial distress?

This is again an issue in FTX, where the Delaware venue of the cases was established through the initial filing of a Delaware-incorporated entity in the US-based exchange silo. Without the bankruptcy of the US exchange silo entities, would the Bahamian silo entities have been able to get into Delaware bankruptcy court at all? Or would they have had to file for bankruptcy in the Bahamas (or elsewhere)? Lest one thinks that venue is not critical in such a case, consider that the English rule on legal fees (loser pays) that would apply in the Bahamas, which would substantially change the incentives for the estate to bring avoidance actions.

LTL has similar implications for Boy Scouts of America (BSA). BSA established Delaware venue through the filing of a newly created Delaware subsidiary with no creditors and no financial distress. Viewed on a per entity basis, the Delaware entity's case should be dismissed (equitable mootness aside) under the LTL standard. Would the main BSA entity be allowed to continue Delaware venue after its venue hook's case is dismissed? Allowing it to enjoy a Delaware venue in such circumstances would all but invite deliberate abuse of the venue statute—every debtor would first file the petition of a newly created subsidiary knowing that dismissal of that subsidiary's petition would have no effect on venue. And as with FTX, there's a clear substantive law implication from the venue: if BSA had filed in

[1] Cf. Suvashree Ghosh, *Bankman-Fried Again Claims FTX US Exchange Was Solvent*, BLOOMBERG, Jan. 17, 2023, *with* Alexander Saeedy, *FTX CEO Says Firm's U.S. Entity Not Solvent, Putting American Customer Funds in Doubt*, WALL ST. J., Dec. 13, 2022.

Texas, where it is headquartered, it would not have been able to get the nondebtor releases that are at the heart of its plan approved under Fifth Circuit law.

LTL provides a tool for challenging venue established by bootstrapping onto the venue of the bankruptcies of corporate affiliates that are not themselves experiencing financial distress. Whether parties will take up this unintended invitation remains to be seen, and given that LTL did not define the modicum of financial distress necessary to whether a motion to dismiss, it is not clear whether the opinion will really have teeth.

The bigger point here is not to say what the outcomes will be, but that the Third Circuit's LTL opinion put a very important marker in the ground for evaluation of a range of issues that have very little to do with mass tort cases or with the use of bankruptcy as a litigation tactic, but go to the problem of a Code drafted for single-entity firms in a world of multi-entity debtors.