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## ***Not the Last Dance* – Court Declines to Dismiss Aldrich Pump’s Texas Two-Step Case But Certifies Direct Appeal to Fourth Circuit**

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The Aldrich Pump Texas Two-Step bankruptcy may have survived dismissal at the bankruptcy court level, but now the asbestos claimants have appealed to the Fourth Circuit following Judge Whitley’s approval of their motion for direct appeal.<sup>1</sup>

Over the past several years, more companies have attempted to use the “Texas Two-Step” strategy to resolve mass tort liabilities through the bankruptcy process. Our previous Client Alert [explained](#) how the process involves the use of the Texas Business Organizations Code to convert a business entity into a Texas organization, then subsequently split it into one or more separate entities via a ‘divisive merger,’ with the bulk of the tort liabilities allocated to one entity.<sup>2</sup> The entity with the tort liability then files chapter 11 in an effort to resolve the claims through the bankruptcy process. The former Trane Technologies Company LLC and Trane U.S. Inc. used the Texas Two-Step to create new entities Murray Boiler LLC (“Murray”) and Aldrich Pump LLC (“Aldrich”) and together with Murray the “Debtors”), which jointly filed chapter 11 in the Western District of North Carolina.<sup>3</sup>

During the Debtors’ three-year long stay in chapter 11, they faced significant challenges, including recently, motions to dismiss filed by the tort claimants’ committee (“TCC”) and another group of asbestos claimants. The claimants primarily sought dismissal on the bases that (i) the cases were filed in bad faith because the Debtors were solvent, non-distressed entities that should not be the subject of bankruptcy proceedings and (ii) cause existed to dismiss the cases under Section 1112(b) of the Bankruptcy Code as the Texas Two-Step was an “improper manipulation” of the bankruptcy process.<sup>4</sup> Judge Whitley denied the motions to dismiss, holding that, unlike the Third Circuit’s decision in *LTL Management*, financial distress is not a prerequisite for filing chapter 11 pursuant to Fourth Circuit authority, and that the vast number of pending asbestos actions and the likelihood of future claims support the Debtors’ eligibility for chapter 11 relief.<sup>5</sup> Judge Whitley further concluded the TCC’s

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<sup>1</sup> See *In re Aldrich Pump LLC*, No. 20-30608 (Bankr. W.D.N.C. 2020), *Notice of Appeal to the United States Court of Appeal for the Fourth Circuit* [Docket No. 2120]; see also *Certification of the Order Denying Motion to Dismiss [Ecf No. 2047] for Direct Appeal to the Court of Appeals for the Fourth Circuit Under 28 U.S.C. § 158(d)(2)* [Docket No. 2111].

<sup>2</sup> TEX. BUS. ORGS. CODE § 1.002(55)(A) (2019).

<sup>3</sup> *In re Aldrich Pump LLC*, No. 20-30608 (Bankr. W.D.N.C. 2020).

<sup>4</sup> *Id.* at Docket Nos 1712 & 1756.

<sup>5</sup> *Id.* at *Order Denying Motions to Dismiss* [Docket No. 2047]. See also *In re LTL Management, LLC*, 64 F.4th 84, 103–04 (3d Cir. 2023) (making “financial distress” a “good faith” prerequisite to a Chapter 11 filing; *But see Carolin Corp v. Miller*, 886 F.2d 693, 700–01 (using a two-prong test requiring objective futility of the case and subjective bad faith of the petitioner). *LTL Management* is the Texas Two Step case filed by [Johnson & Johnson’s spinoff](#) that has been dismissed twice.

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arguments for cause, including that the Texas Two-Step was a manipulation of the bankruptcy process, were simply repackaged bad faith arguments.<sup>6</sup>

In his dismissal order, Judge Whitley questions the efficacy of the Texas Two-Step strategy, noting the long, litigious history of the Debtors' cases. While a dismissal may have blocked (or at least chilled) the ability for other debtors to attempt this strategy, Judge Whitley explicitly noted that higher courts will ultimately determine whether a divisive merger and subsequent chapter 11 filing is a viable method for companies faced with mass tort liabilities.<sup>7</sup>

In addition to defending the motions to dismiss, the Debtors filed a motion asking the court to withdraw its prior grant of derivative standing to the TCC, which enabled it to file adversary proceedings against the Debtors for fraudulent transfer and breach of fiduciary duty claims.<sup>8</sup> The Debtors reasoned that, since the TCC alleged the Debtors were solvent in the motion to dismiss, the TCC was estopped from pursuing the claims.<sup>9</sup> Judge Whitley denied the Debtors' motion, reasoning that the TCC had not succeeded on its motion to dismiss nor had it prevailed on either of the adversaries (at least not yet), so there was no judicial estoppel present.<sup>10</sup> The adversary proceedings and the chapter 11 cases remain open, and the Debtors continue to dance pending the direct appeal of the dismissal to the Fourth Circuit.<sup>11</sup>

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<sup>6</sup> *Id.* at 58.

<sup>7</sup> *Id.* at 21.

<sup>8</sup> Typically, a trustee or the bankruptcy estate would bring such an action, but the TCC previously obtained derivative standing to pursue such actions. Derivative standing is when a person or entity other than the injured party steps in to assert the claim in the injured party's stead. See *La. World Exposition v. Fed. Ins. Co.*, 858 F.2d 233, 247 (5th Cir. 1988).

<sup>9</sup> The Debtors' insolvency is a required element for avoidance of a constructive fraudulent transfer, but as the TCC pointed out in its response and Judge Whitley noted in his order, actual fraud under Section 548(a) and applicable state law has no insolvency requirement.

<sup>10</sup> *In re Aldrich Pump LLC*, No. 20-30608 (Bankr. W.D.N.C. Dec. 28, 2023), *Order Denying Debtor's Motion to Withdraw Derivative Standing from the Official Committee of Asbestos Personal Injury Claimants* [Docket No. 2046].

<sup>11</sup> There is a Texas Two-Step healthcare bankruptcy pending in the Southern District of Texas Bankruptcy Court in which the debtors are also facing motions to dismiss. A hearing on the motions is set for March 5, 2024. See *In re Tehum Care Servs., Inc.*, Case No. 23-90086 (Bankr. S.D. Tex. Feb. 13, 2023) [Docket Nos. 1260, 1380].