

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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PRACTICES Restructuring

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.

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. 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.

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. 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. Judge Whitley further concluded the TCC’s arguments for cause, including that the Texas Two-Step was a manipulation of the bankruptcy process, were simply repackaged bad faith arguments.

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