

Texas Two Step Creates Unique Restructuring Opportunity – But Not Without Challenges

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In the restructuring space, entities are utilizing a strategy dubbed the “Texas Two Step” to resolve mass liabilities through the bankruptcy process. The process involves converting a business entity into a Texas organization and subsequently splitting it into one or more separate entities, with the bulk of the tort or other liabilities allocated to one entity. Subsequently, the entity holding such liabilities files chapter 11 in an effort to achieve a global resolution of the claims.

The Texas Two Step is made possible by the Texas Business Organizations Code, which defines a “merger” to include “the division of a domestic entity into two or more new domestic entities or other organizations.”¹ At its core, a divisive merger is similar to a traditional merger. The agreement and plan of merger must clearly identify the assets and liabilities allocated to each entity involved.²

The Texas Two Step has been utilized by several companies facing mass tort liabilities resulting from asbestos exposure.³ Companies such as Bestwall and Aldrich Pump LLC filed chapter 11 after each was created using the divisive merger statute. Similarly, DBMP LLC, another company facing asbestos liability, filed chapter 11 after it was created by its predecessor entity upon confirmation of the predecessor’s chapter 11 plan, which included a divisional merger support agreement.⁴

The aforementioned cases are pending in the Western District of North Carolina, and the debtors have faced certain challenges from the tort claimants’ committees, including allegations that the divisive merger was a fraudulent transfer. Notably, Texas law specifies that the property allocated to each entity vests without “any transfer or assignment having occurred.”⁵ Nevertheless, the statute does not “abridge any rights or rights of any creditor under existing laws,” including “the Uniform Fraudulent Transfer Act,” which Texas has adopted.⁶

In *Bestwall*, Judge Laura Beyer held “if a debtor used the Texas statute to commit a fraudulent transfer – creating the harm that the Committee complains of – such law would be available to address such acts.”⁷ Relying on the *Bestwall* opinion, in *DBMP*, Judge Craig Whitley noted that, while the Bankruptcy Code does not preempt Texas law on divisional mergers, the Texas Two Step “appears” prejudicial to the rights of the claimants and “is subject to legal challenge.” Further, Judge Whitley concluded that creditors seeking to challenge the divisive merger as fraudulent need to obtain derivative standing to bring such claims.

The most recent case with prospects of a divisive merger is the Imerys Talc bankruptcy. Currently, a motion for a preliminary injunction is pending in the case to prevent Johnson & Johnson from utilizing the Texas Two Step to restructure its talc liability.⁸ In addition to arguing the requirements for a preliminary injunction are met, including that the public interest would be served by preventing a fraudulent transfer, the tort claimants’ committee also argued that a Texas Two Step would violate the automatic stay. The committee cited to the language in the *Bestwall* and *DBMP* suggesting fraudulent transfer liability is possible if the elements of a fraudulent transfer are established. The

case is pending before Judge Silverstein in the Delaware Bankruptcy Court, and she has taken the preliminary injunction matter under advisement.

In sum, the Texas Two Step presents an evolving strategy for companies to divide into multiple entities and potentially shield some assets from the bankruptcy process. Nevertheless, the caselaw involving divisional mergers demonstrates that creditors still raise various challenges to this approach, and the courts facing these issues have not ruled out the potential for fraudulent transfer liability.

¹ TEX. BUS. ORGS. CODE ANN. § 1.002(55)(A) (2019).

² TEX. BUS. ORGS. CODE ANN. § 10.003 (2006).

³ *Bestwall LLC v. Those Parties Listed on Appendix A to Complain and John and Jane Does 1–1000 (In re Bestwall LLC)*, 606 B.R. 243, 246–51 (Bankr. W.D.N.C. 2019); *DBMP v. Those Parties Listed on Appendix A to Complaint and John and Jane Does 1–1000*, Adv. No. 20-03004 (Bankr. W.D.N.C. Jan. 23, 2020); *Aldrich Pump LLC & Murray Boiler LLC v. Those Parties to Actions Listed on Appendix A to Complaint and John and Jane Does 1–1000 (In re Aldrich Pump LLC, et al.)*, Adv. No. 20-030401 (Bankr. W.D.N.C. June 18, 2020).

⁴ *In re DBMP LLC*, No. 20-30080 (Bankr. W.D.N.C. Jan. 23, 2020).

⁵ TEX. BUS. ORGS. CODE ANN. § 10.008(a)(2)(C) (2015).

⁶ TEX. BUS. ORGS. CODE ANN. §§ 24.001–24.013; *DBMP*, Adv. No. 20-03004, *Findings of Fact and Conclusions of Law* [Docket No. 972].

⁷ *Bestwall*, 606 B.R. at 252.

⁸ *Imerys Talc Am. v. Johnson & Johnson, (In re Imerys Talc Am., Inc., et al.)*, Case No. 19-10289, Adv. No. 21-51006 (Bankr. D. Del. 2021). Certain talc claimants also filed an action in Missouri state court seeking to prevent Johnson & Johnson from pursuing a Texas Two Step. Johnson & Johnson removed the action to Federal District Court in Missouri and filed a motion to dismiss for lack of personal jurisdiction. On September 1, 2021, the talc claimants filed a notice voluntarily dismissing the Missouri action. *Victoria Lynne Giese, et al. v. Johnson & Johnson, et al.*, Case No. 21-cv-01064 (E.D. Mo. 2021).