

Texas Two Step: Part Two – Stepping into Other Jurisdictions

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PRACTICES Restructuring

In our [original article](#), we prefaced that Johnson & Johnson (“J&J”) would likely utilize the Texas Two Step to attempt to resolve its tort liabilities related to talc powder.¹ On October 12, 2021, J&J did just that. The company used Texas’s divisive merger statute to spinoff the talc liabilities into a new entity, LTL Management, LLC (“LTL”). After creating LTL via the divisive merger, J&J changed the entity’s domicile jurisdiction from Texas to North Carolina, and LTL filed chapter 11 two days later. The LTL debtor has faced significant challenges since filing the petition.

Judge Craig Whitley, the same judge that stayed litigation against the debtors and their non-debtor affiliates in DBMP and Aldrich Pump, denied a temporary restraining order in LTL’s case² based on, among other things, the fact that the debtor and J&J failed to produce documents to establish that the debtor is responsible for the claims against J&J. Moreover, the court did not appreciate the request for such an important ruling on a “rushed” timeline compared to the requests in the DBMP and Aldrich Pump cases, which the court had more time to decide.

In addition to the TRO denial, Judge Whitley questioned LTL’s decision to file in Northern Carolina. Taking the court’s cue, the bankruptcy administrator and the plaintiff steering committee moved to transfer venue. The court issued a show cause order requesting briefing on whether venue should be transferred to New Jersey, where J&J is based and a substantial amount of litigation is pending, or Delaware. The parties briefed the issue, and, after hearing arguments on November 10, Judge Whitley transferred LTL’s bankruptcy case to the District of New Jersey. Judge Whitley explained that the case belonged in New Jersey where LTL’s parent, employees, and the multi-district litigation is pending. Moreover, he explained that despite LTL’s arguments to the contrary, he had no particular expertise with divisive merger cases. The court did, however, extend the stay to the non-debtor affiliates, including J&J, for 60 days, reasoning he did not want to send the case to the New Jersey bankruptcy court “on fire.” The preliminary injunction expires January 14, 2022, so LTL has requested that the New Jersey Bankruptcy Court make the injunction permanent on the basis that it is critical to the reorganization.

Shortly after LTL was transferred to New Jersey, the Official Committee of Talc Claimants filed a motion to dismiss the case as a bad faith filing.³ The committee asserts, among other reasons, that the debtor’s bad faith is demonstrated by LTL’s prepetition formation, there is no valid reorganizational purpose for the bankruptcy, and the case was filed as a litigation tactic. The motion to dismiss is set for hearing on February 15, 2022.

LTL is not the first divisive merger case to step into jurisdictions outside of North Carolina. For example, Fieldwood Energy LLC (“Fieldwood”) recently completed a successful Texas Two-Step in the Southern District of Texas Bankruptcy Court that involved multiple divisive mergers. The Fieldwood plan, which went effective on August 27, 2021,⁴ proposed a Texas Two Step as part of the plan confirmation process. The Fieldwood case is unique in that it did not deal with mass

tort liabilities to consumers. Instead, Fieldwood faced offshore oil and gas plugging, abandonment and decommissioning liabilities, and the creditors involved were a small group of predecessors-in-interest who previously owned Fieldwood's properties and thus had statutory obligations to remediate those properties in the event Fieldwood was unable to do so. The case is also unique in that the divisive mergers were executed as part of the plan implementation process, rather than at the prepetition stage, so creditors were entitled to vote on the plan that included the mergers.

The plan confirmed in Fieldwood resembles the plans filed in the ASARCO⁵ and ATP⁶ restructurings. Both ASARCO and ATP sought 363 sales within the context of plan confirmation. The plans addressed the issue of insulating "good" assets from "bad" environmental liabilities, but they did so through procedures available in the Bankruptcy Code, rather than the Texas Business Organizations Code.

While Fieldwood demonstrates how a divisive merger in bankruptcy can be accomplished post-petition, the fate of debtors that file chapter 11 after completing prepetition divisive mergers is still unknown. As noted above, LTL is involved in significant litigation with the claimants committee in both the main case and adversary proceeding. Moreover, the divisive merger cases in North Carolina, DBMP, Aldrich Pump, and Bestwall⁷, are still pending and involve ongoing litigation. In our original article, we noted that the claimants committee in DBMP could seek derivative standing to challenge the divisive merger as a fraudulent transfer, which it successfully obtained subsequent to that article. DBMP is also involved in ongoing litigation involving the committee's attempt to substantively consolidate the estate with non-debtor CertainTeed.⁸ The claimants committee in Aldrich Pump is similarly seeking derivative standing to challenge the merger and requested substantive consolidation.⁹

¹ Chavez, Kirincic, and Scales: *Haynes Boone Alert, Texas Two Step Creates Unique Restructuring Opportunity – But Not Without Challenges*.

² *LTL Mgmt., LLC v. Those Parties Listed on Appendix A to Complaint and John and Janes Does 1–1000 (In re LTL Mgmt. LLC)*, Adv. No. 21-03032 (Bankr. W.D.N.C. Oct. 22, 2021), *Disposition of Hearing Held on TRO, Granted in Part and Denied in Part*.

³ *In re LTL Mgmt., LLC*, Case No. 21-30589 (Bankr. D.N.J. 2021) [Docket No. 632].

⁴ *In re Fieldwood Energy, LLC*, Case No. 20-33948 (Bankr. S.D. Tex. Aug. 27, 2021).

⁵ *In re ASARCO LLC*, Case No. 05-21207 (Bankr. S.D. Tex. 2020).

⁶ *In re ATP Oil & Gas Corp.*, Case No. 12-36187 (Bankr. S.D. Tex. 2021).

⁷ Bestwall and the claimants committee are still in the discovery phase of the estimation proceeding for mesothelioma claims. See *In re Bestwall LLC*, Case No. 17-31795 (Bankr. W.D. N.C. 2017).

⁸ The committee asserts that that DBMP's predecessor (old CertainTeed) abused the Texas Two-Step process to divide itself into new CertainTeed and DBMP and "dumped" Old CertainTeed's asbestos liability into DBMP, along with only 3% of its assets, which has

effectively subordinated asbestos claimants to other unsecured creditors and equity holders. On October 25, 2021, CertainTeed and DBMP both filed motions to dismiss the complaint for failure to state a claim, arguing that the Bankruptcy Code does not allow for substantive consolidation of a non-debtor, and that even if it did, the complaint still fails to meet the standard necessary for substantive consolidation. A hearing on the motions is set for December 16, 2021. *Official Comm. of Asbestos Personal Injury Claimants v. DBMP LLC (In re DBMP LLC)*, Adv. No. 21-03023 (Bankr. W.D.N.C. 2021).

⁹ *In re Aldrich Pump LLC*, Case No. 20-30608 (Bankr. W.D.N.C. 2020) [Docket Nos. 848, 893–95 and 905]. A hearing was held on the standing motion December 2, 2021, and Judge Whitley took the matter under advisement. See also *In re Aldrich Pump LLC*, Adv. No. 21-03029 (Bankr. W.D.N.C. 2020)