Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

JANUARY 2022

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 18 NUMBER 1 January 2022

LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Ryan D. Kearns, J.D., at 513.257.9021
Email: .... ryan.kearns@lexisnexis.com
Outside the United States and Canada, please call .... (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at .... (800) 833-9844
Outside the United States and Canada, please call .... (518) 487-3385
Fax Number .... (800) 828-8341
Customer Service Website .... http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or .... (800) 223-1940
Outside the United States and Canada, please call .... (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2022–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 230 Park Ave. 7th Floor, New York NY 10169.

"Texas Two Step" Creates Unique Restructuring Opportunity—But Not Without Challenges

By Jordan Chavez, Alex Kirincic and Cameron Scales*

The authors discuss a strategy being used by more and more companies seeking to resolve mass liabilities in bankruptcy.

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 enters Chapter 11 in an effort to achieve a global resolution of the claims.

WHAT IS A MERGER?

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.

---

* Jordan Chavez, Alex Kirincic and Cameron L. Scales are associates in the Dallas office of Haynes and Boone, LLP. They may be contacted at jordan.chavez@haynesboone.com, alex.kirincic@haynesboone.com and cameron.scales@haynesboone.com, respectively.

[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).

Similarly, DBMP LLC, another company facing asbestos liability, entered 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 U.S. Bankruptcy Court for 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]

BESTWALL AND *DBMP*

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 junction is pending in the case to prevent Johnson & Johnson from utilizing the Texas Two Step to restructure its talc liability.[8]

---

[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

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 *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 bankruptcy court in Delaware, and she has taken the preliminary injunction matter under advisement.

CONCLUSION

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.

---

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).