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# The Texas Two Step of Tort Liability

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## Today's Panelists:



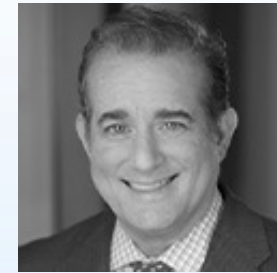
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# The “Texas Two-Step”





## Basic Steps

1. Predecessor corporation (“OldCo”) becomes a Texas corporate entity
2. OldCo undertakes a “divisive merger” and splits into two successor entities - may be two newly formed entities or one newly formed entity and the surviving OldCo
3. OldCo allocates assets and liabilities amongst the successors. One entity (“OpCo”) is allocated the majority of operations, employees, assets, and non-tort liabilities, and the other (“FilingCo”) is allocated remaining assets and all tort liabilities
4. FilingCo and new parent/affiliates enter into Funding and Service Agreements that purport to cover FilingCo’s tort liabilities and operating / bankruptcy costs
5. FilingCo files for chapter 11 to confirm a plan that provides for a litigation trust and channeling injunction directing all present and future tort-related claims against any “Protected Party” to the trust as their sole recourse

Tex. Bus. Org. Code Ann. § 10.008 *et. seq.*

## Key Cases

- *In re Bestwall LLC*, No. 17-31795 (Bankr. W.D.N.C.) (LTB)
- *In re DBMP LLC*, No. 20-30080 (Bankr. W.D.N.C.) (JCW)
- *In re Aldrich Pump LLC*, No. 20-30608 (Bankr. W.D.N.C.) (JCW)
- *In re Paddock Enterprises LLC*, No. 20-10028 (Bankr. D. Del.) (LSS)
- *In re Imerys Talc America, Inc.*, No. 19-10289 (LSS)

# Preliminary Views & Attempts to Enjoin

- “I do not see that the use of the Texas Business Organizations Code in the way described ... amounts to a violation of the automatic stay ... If there are [not] sufficient assets put into the new bankruptcy-bound entity ... there appear to be many avenues of relief.” *In re Imerys* [Dkt. 3975]
- “Plaintiffs are entitled to have their cases decided in a court of law based on the merits of their cases. Similarly, Defendants who happen to be large corporations are entitled to defend their cases ... [and] to have their fiduciary decisions scrutinized but the basis for said scrutiny must have merit and not based on hypothetical scenarios.” *Brandi Carl*, No. ATL-L6546-14
- “[T]he TBOC permits a company to engage in a divisional merger, it does not permit that company to thereby prejudice its creditors ... an action to contest the merger and its exclusive allocation of all ... asbestos claims ... appears to be a viable cause.” *In re DBMP* [Dkt. 972]



*In re LTL Management LLC,*  
No. 21-30589  
(Bankr. W.D.N.C.) (JCW)



## Ch. 11 Filing and J&J Entities / Liabilities

- According to first day papers, through historical intercompany transactions, Johnson & Johnson Consumer Inc. (“Old JJCI”) was liable for all J&J asbestos and talc-related claims
- After divisional merger / corporate restructuring completed on October 12, 2021, Old JJCI ceased to exist, and its assets were allocated between Johnson and Johnson Consumer Inc. (“New JJCI”) and LTL Management LLC (“LTL” or the “Debtor”)
- LTL converted from a Texas LLC to a North Carolina LLC and filed for chapter 11 in the Western District of North Carolina on October 14, 2021
  - LTL assets include (i) \$6 million cash, (ii) interests in Royalty A&M LLC; and (iii) rights and interests under the Funding Agreement



# Players

- Debtor's Parent & New Affiliate
- Talc Claimants Committee & Future Claimants Representative
- U.S. Trustee / Bankruptcy Administrator
- Insurers
- Experts & Financial Advisors



# Preliminary Injunction

- Debtor typically initiates an adversary proceeding and filings a complaint and motion for TRO / preliminary injunction to halt all underlying tort litigation
- Injunction intended to cover Debtor and “Protected Parties”
  - Parties “who share such an identity of interests with the Debtors that the Debtors are, in effect, the real party defendants”
    - Non-Debtor Affiliates
    - Insurers
    - Retailers
  - “Permitting claimants to indirectly establish claims against the Debtor through actions against third parties with indemnity rights is inconsistent with section 524(g)’s goal of consolidating and collectively resolving all asbestos claims, current and future, in the Chapter 11 case.” *In re Bestwall*, 606 B.R. at 254

## Preliminary Injunction - J&J/LTL

- LTL initially sought an order declaring that the automatic stay applied to all Protected Parties, including J&J and New JJCI. After feedback from Judge Whitley, LTL pivoted to an adversary proceeding and a motion for a TRO and preliminary injunction.
- At November 4 hearing, Judge Whitley initially expressed “grave concerns” that J&J may have its own asbestos and talc liability independent of Old JJCI or LTL
- At conclusion of November 10 hearing, Judge Whitley granted a 60-day injunction in order to permit New Jersey court time to consider further extension
  - After presentation of evidence, ultimately concluded that claims against J&J’s proposed Protected Parties were “effectively claims against the debtor” and could “conceivably have an effect on the estate”



## Challenges: Bad Faith

- Under 4<sup>th</sup> Circuit law, a court may dismiss as a bad faith filing when the bankruptcy reorganization is (i) objectively futile and (ii) filed in subjective bad faith. *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989)
- In *Bestwall*, Judge Beyer held that “attempting to resolve asbestos claims through [524(g)] is a valid reorganizational purpose, and filing for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency”
- Judge Whitley has noted the difficulty in prevailing on bad faith in light of *Carolin* and *Bestwall*

## Challenges: Fraudulent Transfer

- “If in a merger with multiple survivors, the parties allocate a creditor's claim to an inadequately capitalized or insolvent corporation, that creditor will have the right to challenge the merger as a fraudulent transfer.” *In re Aldrich*, 2021 WL 3729335 (quoting Curtis Huff, The New Texas Business Corporation Act Merger Provisions)
- In October, Judge Whitley granted standing to the ACC and FCR in *DBMP* to pursue fraudulent transfer claim
- Key Issue: Funding & Service Agreements
  - J&J/New JJCI agree to fund costs of administering chapter 11 cases, ordinary course expenses, and amount necessary to satisfy talc liabilities
  - Committed to prefund a Qualified Settlement Fund with \$2 billion
  - J&J Services agrees to provide LTL and Royalty A&M corporate and administrative services

# Valuation / Estimation

- Valuation of LTL assets
  - According to first day papers, \$6mm cash + FMV of interest in Royalty A&M of \$367mm
- Valuation of New JJCI
  - Funding commitment up to the value of New JJCI
  - New JJCI ability to fulfill commitment under Funding Agreement
  - Further ability to make additional contributions if needed
- Estimation of all current and future asbestos or talc claims
  - Is potential and actual funding for LTL going to be adequate?
  - Whitley approved *DBMP* debtor's estimation motion in dual track with fraudulent transfer action
  - Estimation proceedings in *Bestwall* to commence in March 2022



## Venue

- Western District of North Carolina is the preferred venue for Texas Two-Step cases
- Judge Whitley *sua sponte* directed briefing on transferring venue of LTL from W.D.N.C.
  - Concerns over connection to North Carolina, balancing of interests with tort litigants, and overload of court docket and capacity
- On November 10, granted transfer of LTL to the District Court for the District of New Jersey
  - That W.D.N.C. has substantial jurisprudence and experience with Texas Two-Step cases does not outweigh other factors favoring transfer, including convenience for parties and forum of N.J. for J&J's MDL and MCL

## Legislation / Regulation

- Recent legislation, the Non-Debtor Release Prohibition Act of 2021, has been proposed in response to cases like *LTL*, *Purdue Pharma* and *Boy Scout of America*
  - Introduces new section to the Bankruptcy Code that would (i) impose restrictions on court with respect to approving plan provisions that discharge or modify the liability of a non-debtor entity and (ii) limit any order temporarily staying proceedings against a non-debtor to 90 days except upon the affected creditors' consent
  - Proposes amendment to section 1112 that would permit dismissal if the debtor or its “predecessor” was “formed or organized in connection with a divisional merger or equivalent transaction ... [which] had the intent or foreseeable effect of separating material assets from material liabilities ... [and] assigning or allocating all or a substantial portion of those liabilities to the debtor” within 10 years of petition date

# Faculty: The Texas Two Step of Tort Liability

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## **Stephen Darr**

Stephen has more than three decades of experience helping organizations across industries navigate complex accounting, auditing and financial management issues. He has also provided litigation support and expert testimony in bankruptcy and non-bankruptcy matters involving preference and fraudulent conveyance actions, professional liability claims, patent infringement, royalty and intellectual property disputes, construction claims, wrongful employment discharge and lender liability and business tort claims.

He has testified in U.S. bankruptcy court proceedings in states across the East Coast on a wide range of bankruptcy matters, including business plan feasibility, debtor-in-possession financing, substantive consolidation issues, cash collateral arrangements, valuation, reorganization tax issues and key employee retention plans.

Prior to joining Huron, Stephen held leadership roles at Mesirow Financial, KPMG and EY. He is a fellow in the American College of Bankruptcy.]

## **Jamie Fell**

Jamie Fell is an Associate in the Restructuring and Bankruptcy Practice of Simpson Thacher. Jamie's representations include both out-of-court restructurings and chapter 11 cases involving companies in financial distress, private equity sponsors, and financial institutions as lenders and agents. She received her J.D. from the University of Texas School of Law and her B.A. from New York University.

## **Benjamin Mintz**

Benjamin Mintz has practiced in the restructuring and bankruptcy area for more than 25 years. He has extensive transactional and litigation experience and has played active roles in many high-profile restructuring matters. Mr. Mintz's transaction experience is broad-based and includes the negotiating and drafting of complex asset purchase agreements, loan agreements, investment agreements, subordination and intercreditor agreements, factoring agreements, and reorganization plans. He has also been actively involved in litigation matters throughout the country, including bankruptcy courts, federal district courts, state courts, and appellate courts.

Mr. Mintz's clients include ad hoc lender groups, lenders, hedge funds, asset managers, administrative agents, indenture trustees and other senior secured investors as well as debtors, creditor committees, litigation/liquidation trustees, fiduciaries, equity holders, sovereigns, and other individual creditors. Mr. Mintz has experience in a variety of



industries including health care, real estate, energy, airlines, travel, retail, financial, gaming, manufacturing, entertainment, telecommunications, and apparel. Mr. Mintz also has extensive experience in distressed M&A, having represented both buyers and sellers in complex distressed acquisition transactions, involving operating assets, financial assets and real estate.

### **Prof. Pamela Foohey**

Professor Pamela Foohey's research centers on bankruptcy, commercial law, and consumer law. Her work primarily involves empirical studies of bankruptcy and related parts of the legal system, combining quantitative and qualitative, interview-based research. She is a co-investigator on the [Consumer Bankruptcy Project](#), a long-term research project studying persons who file bankruptcy. The results of this research have been featured in top media outlets, including [The New York Times](#), [Financial Times](#), [NPR](#), [U.S. News & World Report](#), and [The Washington Post](#). Professor Foohey's work in business bankruptcy focuses on non-profit entities, with a particular emphasis on how churches and other religious organizations use bankruptcy. The results of this research likewise have been featured in media outlets such as [Bloomberg](#), [CBS News Moneywatch](#), and [Reveal](#). Professor Foohey also is a contributor to the blog [Credit Slips](#), a discussion on credit, finance, and bankruptcy.

Professor Foohey is the current chair of the Law and the Social Sciences' Section of the Association of American Law Schools (AALS) and is on the executive committees of several other AALS Sections. She serves on the editorial advisory board of the Law & Society Review, and recently completed a three-year appointment to the editorial advisory board of the American Bankruptcy Law Journal, a peer-reviewed academic law review published by the National Conference of Bankruptcy Judges. In 2019, the American Bankruptcy Institute named her a "40 Under 40" Emerging Leader in Insolvency Practice.

Professor Foohey joined the Cardozo School of Law in 2021 from the Indiana University Maurer School of Law. At the Maurer School of Law, she taught bankruptcy, contracts, corporations, and secured transactions, and chaired the Center for Law, Society & Culture's advisory board. During her time at IU, Professor Foohey received the Gavel Award for outstanding contribution to the graduating class, the IU Trustees' Teaching Award for excellence in teaching, and the Leon H. Wallace Teaching Award, the highest teaching honor given to Maurer School of Law faculty.

Prior to teaching, Professor Foohey clerked for the Honorable Thomas L. Ambro of the Third Circuit Court of Appeals, worked as an associate in the Bankruptcy and Financial Restructuring Group of Dorsey & Whitney LLP in Minneapolis, and clerked for the Honorable Peter J. Walsh of the Bankruptcy Court for the District of Delaware.