# A SHOWDOWN OVER THE 'Texas Two-Step'

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The Texas two-step is an iconic dance. Many readers may have memories of learning the dance steps in elementary school gym classes as training for future jaunts to legendary Texas venues like Gruene Hall or Billy Bob's.

These days, a Texas two-step of sorts is the talk of the restructuring world, but, unfortunately, it has little to do with dim lights and smokey dance halls. Instead, all eyes are on a legal two-step—step one being reincorporation in Texas, with step two consisting of a divisive merger creating corporate silos holding different assets and liabilities. The question of the day is whether the music is about to stop for good for this version of the Texas two-step.

The ability to use the Texas two-step as a restructuring tool is subject to bankruptcy litigation involving an affiliate of Johnson & Johnson. Like many entities facing mass tort liabilities, Johnson & Johnson's consumer products entity used the Texas two-step to create a separate entity to house the liabilities associated with a large volume of talc-related litigation. The entity formed by divisive merger—LTL Management LLC—then filed Chapter 11 bankruptcy "to resolve permanently all mass tort claims relating to its cosmetic talc products in a manner that is efficient and equitable to all parties, including current and future claimants." *In re LTL Management LLC*, Case No. 21-30589, Doc. No. 3 at 4 (Bankr. D.N.J.).

As might be expected, tort claimants have been critical of the filing given the assets walled off from LTL Management and the substantial market capitalization of the newly formed entity's ultimate parent, Johnson & Johnson. A number of parties have moved to dismiss the LTL Management bankruptcy as a bad faith filing, and a decision on whether the dance may go on is expected in the coming months.

While any practitioner involved in tort cases should watch *LTL Management,* the case also has significant implications for the energy restructuring world, where the Texas two-step has also been used. This article briefly discusses a recent notable use of the strategy in the energy space before moving on to the LTL Management litigation.

## All My Exes Live in Texas

The Texas divisive merger process is set out in Chapter 10 of the Texas Business Organizations Code, which describes the requirements of a plan of merger. Section 10.003 lays out the requirements when a plan of merger results in multiple entities—a so-called "divisive" or "divisional" merger. The plan of merger must include "the manner and basis of allocating and vesting the property of each organization that is a party to the merger among one or more of the surviving or new organizations." Tex. Bus. Orgs. Section 10.003(1).

On the other side of the balance sheet, the plan of merger must include "the manner and basis of allocating each liability and obligation of each

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organization that is a party to the merger, or adequate provisions for the payment and discharge of each liability and obligation, among one or more of the surviving or new organizations." Tex. Bus. Orgs. Section 10.003(3). Upon completion, the merger has the effect of vesting the assets and liabilities in the newly formed entities. See Tex. Bus. Orgs. Section 10.008.

The divisive merger process took center stage this past year in the bankruptcy case of Fieldwood Energy, LLC, Case No. 20-33948, in U.S. Bankruptcy Court for the Southern District of Texas. Fieldwood Energy and its affiliates owned and operated oil and gas leases primarily on the outer continental shelf of the Gulf of Mexico. According to the disclosure statement approved in the case, as of the petition date Fieldwood operated more than 300 oil and gas platforms spread over 1.5 million gross acres and consisting of a mix of shallower shelf properties acquired primarily from Apache and some deep-water assets acquired from Noble in Fieldwood's 2018 restructuring. Given this mix of assets, Fieldwood entered bankruptcy with significant plugging and abandonment liabilities on the heels of the notable oil price plummet in the spring of 2020.

Faced with a mix of aging oil and gas leases and other, more productive oil and gas leases, Fieldwood turned to a combination of the Bankruptcy Code's sale process and the Texas divisive merger statute to divide the assets. Fieldwood's secured lenders acquired Fieldwood's better producing deep-water assets through a combination of cash and credit bid purchase.

In coordination with certain of Fieldwood's predecessors in title, Fieldwood used the Texas divisive merger statute to create silos of assets to address distinct predecessor lease interests and related liabilities. These silos included an entity to house legacy Apache leases, an entity for legacy Chevron leases, and an entity to pick up certain "sole liability" leases along with certain legacy Hunt and Eni leases. A final set of leases were "abandoned" by Fieldwood through the confirmed plan.

Thus, in a completely different context from the mass tort cases, Fieldwood demonstrated how the Texas divisive merger statute can be deployed in an energy restructuring. While time will tell how effective the process was at addressing the plugging and abandonment liabilities, the divisive merger tool certainly provided a structure to allow Fieldwood to confirm a plan and exit bankruptcy.

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## Last Dance?

Energy companies hoping to follow Fieldwood's twirls around the dance floor may find that they've reached last call, depending on the outcome of the LTL Management case. LTL Management's turn to the Texas two-step was prompted by litigation claims—not significant environmental liabilities. LTL Management noted in a brief filed early in the case that in one state court tort case alone a jury awarded $4.69 billion to 22 plaintiffs. See *In re LTL Management LLC,* Case No. 21-30589, Doc. No. 3 at 4 (Bankr. D.N.J.).

While LTL Management argued it had success in some jury trials, it asserted that the range of liabilities and potential for additional large jury awards threatened its ability to satisfy future claims. *Id*. Therefore, Johnson & Johnson's consumer products entity used the Texas divisive merger statute to create LTL Management, which received all talc-related liabilities and a royalty management and finance business that LTL Management asserted had assets of $350 million.

In addition, Johnson & Johnson and the new consumer products entity agreed to fund $2 billion to pay talc-related claims. As a result of these funding commitments, LTL Management argued that the divisive merger did not prejudice claimants and will be sufficient to pay legitimate claims.

Certain creditors filed motions to dismiss, asserting the divisive merger and subsequent bankruptcy filing constituted a bad faith filing requiring dismissal of the bankruptcy case. They asserted the divisive merger had the effect of creating "GoodCo" and "BadCo" to isolate a healthy consumer products business from talc liabilities. See *In re LTL Management LLC*, Case No. 21-30589, Doc. No. 766 at 3-4 (Bankr. D.N.J.); see also Doc. No. 632. They argued that Johnson & Johnson had no real financial distress, could satisfy tort claims in the ordinary course of business, and filed the bankruptcy primarily to avoid jury trials. *Id*. at 21-24. While acknowledging this approach had been used in asbestos cases previously, creditors warned that LTL Management could create a road map for similar restructurings in the future. *Id*. at 11, 30-31.

The circumstances in the LTL Management case are unique, but the outcome could be quite important for all types of restructurings going forward. Any limits placed on the ability to use the Texas divisive merger statute as part of a Chapter 11 restructuring could significantly change the legal options for companies facing mass tort, or really any other kind of significant, liabilities. Ultimately, the question likely to work its way up to the 3rd Circuit is whether it's time to turn out the lights on the Texas two-step. The party may be over.