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United States Senate

"Abusing Chapter 11: Corporate Efforts to Side-Step Accountability
Through Bankruptcy"

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WRITTEN TESTIMONY OF KEVIN C. MACLAY

I would like to thank Chairman Whitehouse, Ranking Member Kennedy, and Members of the Subcommittee for inviting me to testify before this Subcommittee regarding "Abusing Chapter 11: Corporate Efforts to Side-Step Accountability Through Bankruptcy." My name is Kevin Maclay. I am a member of the law firm of Caplin & Drysdale, Chartered in Washington, DC, where my practice focuses on protecting creditors' rights in corporate chapter 11 bankruptcy reorganizations. I have represented the interests of numerous tort creditors' committees, and significant tort creditors in major Chapter 11 bankruptcy proceedings across the country, and I and my firm currently serve as lead or co-lead counsel to tort creditors' committees in the bankruptcies of Paddock Enterprises LLC (Owens-Illinois), DBMP LLC (CertainTeed), Aldrich Pump LLC and Murray Boiler LLC (Trane and Ingersoll-Rand), ON Marine Services Company (Ferro), Cyprus Mines Corporation, and Kaiser Gypsum Inc. and Hanson Permanent Cement Inc. As a result of that experience, I am familiar with the bankruptcy process generally, mass tort bankruptcies in particular, and with the recent attempts by certain mass tort defendants to create a one-sided escape from both the tort and bankruptcy systems through use of the so-called "Texas Two-Step."

Summary

Since 2017, five different companies have filed for bankruptcy after undergoing what is referred to as a "divisional merger" under a somewhat obscure and previously-little-utilized provision of Texas law. They have done so to put their assets out of the reach of creditors and the courts, an unprecedented legal maneuver that undermines the entire civil justice system. All five were large and profitable companies with substantial assets (collectively above 80 billion dollars), part of extremely wealthy corporate families (collectively worth many hundreds of billions of dollars). None of them claimed to be insolvent. Nor were any of them Texas companies either before or after the so-called Texas Two-Step was complete. All five were and are out-of-state companies whose existence as Texas corporations lasted mere hours, in a brazen attempt to exploit what they viewed as a loophole under federal bankruptcy law. The most recent such bankruptcy filing, and the most publicized, is that by Johnson & Johnson's recently-created shell company, LTL Management LLC ("LTL").

Under the Texas Two-Step, a rich and successful company effectively divides itself into two new companies. One of the companies (the "GoodCo") receives the lion's share of the business assets; the other (the "BadCo") receives all of the unwanted tort liabilities. Days later, the company with the unwanted liabilities files for chapter 11 bankruptcy, while the richer company with the vast majority of the assets remains outside of bankruptcy. This violates fundamental bankruptcy principles, including that companies should bear the burdens of bankruptcy in order to enjoy its benefits, and the associated principle that debtors should come into bankruptcy with both all of their liabilities and all of their assets.[1]

Unless a stop is put to it, the Texas Two-Step effectively places corporations willing to stoop to it above the law. Tort victims can no longer seek redress for their injuries in the court

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[1] A "cardinal principle of bankruptcy" is to provide relief to only those debtors that come into bankruptcy with all of their liabilities *and* all of their assets. *Robbins v. Chase Manhattan Bank, N.A.*, No. CIV A. 93-0063-H, 1994 WL 149597, at *6 (W.D. Va. Apr. 4, 1994) (quoting *In re Venture Props., Inc.*, 37 B.R. 175, 177 (Bankr. D.N.H. 1984)).

system, as such corporate defendants argue, so far successfully, that the bankruptcy filing by their BadCo likewise protects their GoodCo from lawsuits. Yet their GoodCo remains outside of bankruptcy and free from the transparency and court oversight usually required as a condition of such bankruptcy protection.

And there are major consequences to the abuse of the Texas Two-Step loophole. As of the dates of their bankruptcy filings, there were hundreds of thousands of claims collectively pending against Georgia Pacific, CertainTeed (part of the Saint-Gobain corporate family), Ingersoll-Rand, Trane, Johnson & Johnson, and their affiliates. Those injured victims have now been trapped in illegitimate bankruptcies manufactured by undeniably wealthy companies. Those victims include dead and dying individuals, or their survivors, some of whom likely have few, if any, other options and are in desperate financial straits. At a minimum, the Texas Two-Step has resulted in substantial delays to their ability to seek justice, and potentially could even eliminate that ability. These are real-world problems, not merely academic concerns, and fundamental fairness is at stake.

While the Texas Two-Step so far has been used to disadvantage tort victims, the very same mechanism can, and will, inevitably be used to permit corporations to rid themselves of any unwanted creditors—contract creditors, warranty claim creditors, environmental creditors or others. The Texas Two-Step is a free pass for a corporation to disregard its obligations under the law at will. Unless this loophole is closed, more corporations will engage in the Texas Two-Step scheme, and twist the bankruptcy system into something unrecognizable.

Corporations, no matter how wealthy they are and no matter how clever the lawyers they hire, should not be able to unilaterally remove themselves from both the U.S. civil justice system and the federal bankruptcy system. No one should be above the law.

In other words, it is up to Congress to deliver needed reform.

Chapter 11 Reorganizations

When Congress enacted the modern Bankruptcy Code in 1978, it struck a careful balance in providing essential benefits to financially distressed debtors seeking to reorganize while at the same time requiring those debtors to fulfill obligations that provide important protections to creditors.[2] Bankruptcy is designed to benefit the "honest but unfortunate debtor."[3] Since 1978, chapter 11 of the Bankruptcy Code has enabled business debtors to work with their creditors to negotiate a plan of reorganization that restructures their balance sheets or business operations, eases their financial distress, and preserves the going-concern value of the business in an effort to maximize creditor recoveries.

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[2] *See* 2 COLLIER ON BANKRUPTCY ¶ 1100.01 (Richard Levin & Henry J. Sommer eds., 16th ed.).

[3] "Since the Code limits the opportunity for a completely unencumbered new beginning to the honest but unfortunate debtor by exempting certain debts from discharge, it is unlikely that Congress would have fashioned a proof standard that favored an interest in giving the perpetrators of fraud a fresh start over an interest in protecting the victims of fraud." *Grogan v. Garner*, 498 U.S. 279, 279 (1991).

Chapter 11 provides certain benefits to debtors to facilitate negotiations and ultimately a successful reorganization. The principal benefit to debtors is the automatic stay,[4] which provides a statutory, nationwide, and indefinite stay of litigation, collection actions, and enforcement proceedings against the debtor. The automatic stay has two primary purposes: first, it provides the debtor with a pause from litigation to work out financial difficulties and to begin the process of reorganization; and, second, it prevents a race to the courthouse by creditors to sue and dismember the debtor, which can destroy value and defeat an orderly reorganization process.[5]

In exchange for the benefits of bankruptcy, the Bankruptcy Code imposes corresponding obligations on debtors that are intended to protect creditors:

- First, debtors are required to make regular reports to their creditors and the bankruptcy court, including information about their assets, liabilities, and financial affairs at the start of the case, and subsequent monthly operating reports to monitor cash flow.[6] These reporting requirements create an environment of transparency to help creditors understand the debtor's financial state of affairs, which in turn informs plan negotiations and the debtor's reorganization.[7] They also help to prevent misuse or misappropriation of those assets.

- Second, the chapter 11 debtor cannot layer on additional debt or engage in any transactions outside the ordinary course of business, such as selling any material assets, without prior notice to creditors and the approval of the bankruptcy court.[8] The purpose of these protections is to prevent debtors or the entities controlling debtors from overleveraging a debtor that is already in financial distress or from stripping the debtor of its assets either for no value or for less than fair value.[9]

- Third, although the Bankruptcy Code initially grants the debtor the exclusive right to propose a chapter 11 plan, that right eventually terminates, thereby giving creditors the ability to propose a competing chapter 11 plan and thus a more level playing field to help shape the outcome of the reorganization.[10]

- Fourth, creditors ordinarily can be paid only in accordance with a chapter 11 plan that

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[4] 11 U.S.C. § 362(a).

[5] *See, e.g.*, *Dean v. Trans World Airlines, Inc.*, 72 F.3d 754, 755-56 (9th Cir. 1995).

[6] *See* 11 U.S.C. § 521; Fed. R. Bankr. P. 1007.

[7] *See In re Sillerman*, 605 B.R. 631, 644 (Bankr. S.D.N.Y. 2019) (stating the Bankruptcy Code's reporting requirements "cannot be ignored" and are necessary to "supply the Court and creditors with relevant and material information . . . thereby enhancing transparency and potentially laying bare any improper transfers or self-dealing"); *In re Berryhill*, 127 B.R. 427, 433 (Bankr. N.D. Ind. 1991) ("Timely and accurate financial disclosure is the life blood of the Chapter 11 process."); *cf. In re V Companies*, 274 B.R. 721, 739 (Bankr. N.D. Ohio 2002) ("While creditors may not be happy with the way in which a bankruptcy case unfolds, at a minimum they are entitled to reasonable assurances that the debtor's affairs are being conducted in a transparent manner with an eye to the debtor's fiduciary obligations to the creditors.").

[8] *See* 11 U.S.C. §§ 363(b), (f), 364; 2 COLLIER ON BANKRUPTCY ¶ 363.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

[9] *See, e.g.*, *Horse Haven, Inc. v. Stephens*, 907 F.2d 1138 (4th Cir. 1990); *In re Cook & Sons Mining, Inc.*, No. CIV.A. 05-19, 2005 WL 2386238, at *6 (E.D. Ky. Sept. 28, 2005).

[10] *See* 11 U.S.C. § 1121.

satisfies the Bankruptcy Code's requirements and is approved by the bankruptcy court after notice and a hearing.[11]

- Fifth, an "absolute priority rule" is embodied in the Bankruptcy Code and generally provides that, unless creditors consent to less favorable treatment, creditors must be paid in full before the debtor's owners—oftentimes shareholders—can retain their shares or ownership interests in the debtor.[12]

The Texas Two-Step undermines these essential creditor protections and disrupts the careful debtor-creditor balance crafted by Congress.

Overview of Divisional Mergers Implemented for Bankruptcy Purposes

Instead of describing each and every divisional merger and follow-on bankruptcy that has occurred, I will use a hypothetical to illustrate how these divisional mergers typically work and how they make the ensuing chapter 11 bankruptcies so problematic. For those wishing to know more about the divisional mergers that actually occurred, I lay out in the accompanying appendix how the divisional mergers involving five major companies were implemented and set the stage for their follow-on chapter 11 bankruptcies (two of which, Aldrich and Murray, are jointly administered). Those cases all remain pending, are highly contested, and appear no closer to a resolution than the day they began.

Suppose there is a company named "AceCo." AceCo, which was formed in Delaware, is a successful company, with a strong balance sheet and a line of products generating substantial cash. But AceCo has overhanging tort liabilities to individuals harmed by its products. Although AceCo has more than enough cash to defend itself in the tort system and to settle and pay the tort claims as they arise, AceCo's management wants to rid AceCo of its tort liabilities once and for all. Bankruptcy may provide a path for resolving the tort liabilities in a single proceeding, but AceCo's management does not want to put AceCo into bankruptcy because of the perceived reputational harms, court oversight, required transparency and associated costs. To obtain the

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[11] *See id*. §§ 1128, 1129; *see also Off. Comm. of Equity Sec. Holders v. Mabey*, 832 F.2d 299, 302 (4th Cir. 1987) ("The Bankruptcy Code does not permit a distribution to unsecured creditors in a Chapter 11 proceeding except under and pursuant to a plan of reorganization that has been properly presented and approved. . . . The clear language of . . . [11 U.S.C. §§ 1121-1129], as well as the Bankruptcy Rules applicable thereto, does not authorize the payment in part or in full, or the advance of monies to or for the benefit of unsecured claimants prior to the approval of the plan of reorganization."); *In re Berry Good, LLC*, 400 B.R. 741, 744 (Bankr. D. Ariz. 2008) ("[I]n the context of a reorganization proceeding, pre-petition debt may not be paid in the absence of a confirmed reorganization plan."); *In re All Trac Transp., Inc.*, 306 B.R. 859, 875-76 (Bankr. N.D. Tex. 2004) ("Outside of a Chapter 11 plan of reorganization confirmed by the bankruptcy court, the Bankruptcy Code does not provide for the pre-plan payment of pre-petition unsecured debt.").

[12] *See id*. §§ 726(a), 1129(a)(7), 1129(b); *see also Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 979 (2017) ("The Code places equity holders at the bottom of the priority list. They receive nothing until all previously listed creditors have been paid in full."); 2 COLLIER ON BANKRUPTCY ¶ 1100.01 (Richard Levin & Henry J. Sommer eds., 16th ed.) ("[T]he principle that business reorganizations should be fair and equitable between classes of differing security or priority is embodied in chapter 11 through the absolute priority rule, which has been aptly described as 'the organizing principle of the modern law of corporate reorganizations.'" (citations omitted)).

benefits of bankruptcy without putting the entire business into chapter 11, AceCo decides to utilize Texas law and implement a divisional merger.

To accomplish this, AceCo first converts from a Delaware company to a Texas company. Then, as a Texas company, AceCo utilizes the Texas divisional merger law to effectively split itself into two new companies, "GoodCo" and "BadCo." As a formal legal matter, AceCo ceases to exist. GoodCo and BadCo are directly or indirectly owned by the same parent holding companies that once owned AceCo.

As part of the divisional merger, GoodCo receives 99% of AceCo's assets and all of AceCo's non-tort liabilities. BadCo receives 1% of AceCo's assets and *all* of AceCo's tort liabilities. BadCo has no employees or business operations. Apart from BadCo's officers and board members, who are also employees of GoodCo or its parent companies, a bare-bones in-house legal team is loaned or seconded to BadCo to manage the pending tort litigation against BadCo (as successor in interest to AceCo) until BadCo files for bankruptcy.

At the same time, to cast a veneer of supposed legitimacy on this scheme, GoodCo and BadCo enter into a "funding agreement" whereby GoodCo promises to provide funds to BadCo, if needed, during BadCo's remaining few weeks in the tort system and in the bankruptcy. But the so-called "funding agreement" is illusory, providing control to GoodCo and numerous opportunities to use it to GoodCo's advantage.

After spending only a few hours as Texas entities to complete the divisional merger, GoodCo promptly converts itself from a Texas company back to a Delaware company—just as AceCo was—and BadCo converts itself from a Texas company to a North Carolina company in order to establish a bankruptcy venue in the Western District of North Carolina.

Within a matter of days, BadCo files for chapter 11 bankruptcy with the U.S. Bankruptcy Court for the Western District of North Carolina. As a result of the chapter 11 filing, all tort suits and collection actions by tort claimants against BadCo are automatically stayed.[13] Thereafter, the bankruptcy court overseeing BadCo's chapter 11 case grants a preliminary injunction and/or rules that the automatic stay indefinitely enjoins tort claimants from suing GoodCo and all of its nonbankrupt affiliates on account of AceCo's tort liabilities as well.

While sitting outside chapter 11 but protected by a bankruptcy stay, GoodCo continues to run the same businesses that AceCo once did, manufacture the same products that AceCo once did, and sell to the same customers that AceCo once did. (GoodCo even adopts AceCo's name, but, for purpose of clarity here, I will continue to refer to GoodCo as "GoodCo.") GoodCo pays its (non-tort) creditors, the former vendors and suppliers of AceCo, in the ordinary course of business. And, as AceCo once did, GoodCo regularly distributes its substantial earnings to its direct and indirect parent companies. For non-tort creditors, shareholders, employees and other stakeholders in GoodCo, which is now doing business as "AceCo," nothing has changed with the divisional merger and follow-on bankruptcy; everything is still "business as usual."

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[13] *See* 11 U.S.C. § 362(a).

By contrast, everything has changed for the tort creditors as a result of the divisional merger and follow-on bankruptcy filing. Beforehand, tort creditors had direct recourse against AceCo; they could fix judgment liens against AceCo's assets if they prevailed in litigation against AceCo. As a result of the Texas Two-Step, however, the recourse of tort creditors is limited to BadCo, which is only a very stripped-down version of AceCo. GoodCo touts the funding agreement as providing recourse that is equivalent to what tort creditors had against AceCo, but that is not the case. Such a contract is not equivalent to the cash and assets that have been stripped away. Moreover, the tort creditors are not parties to the funding agreement, and the agreement itself expressly excludes them as third-party beneficiaries. Accordingly, tort creditors likely cannot even sue GoodCo to enforce its obligations under the funding agreement; those creditors must instead rely on BadCo to do so. But BadCo is controlled by GoodCo and its affiliates.

Impact of the Divisional Merger on Chapter 11 Proceedings

With bankruptcy stays in place shielding BadCo's entire enterprise group—*i.e.*, BadCo, GoodCo, and their affiliates—GoodCo and the affiliates enjoy a principal benefit of bankruptcy without actually being in bankruptcy, *i.e.*, an indefinite, nationwide stay of tort claims. But GoodCo and its affiliates are also free of the obligations normally required of a chapter 11 debtor—obligations that constitute essential creditor protections, to wit:

- GoodCo is not required to file schedules of its assets and liabilities, a statement of financial affairs, and monthly operating reports, thereby foreclosing any transparency regarding GoodCo's financial condition or what it is doing with the money that is supposedly available to pay its tort victims.

- GoodCo can layer on debt that is senior in priority to its obligations under the funding agreement and can engage in transactions outside the ordinary course of business, including transferring its entire value, without any notice to tort creditors and without first obtaining the bankruptcy court's approval.

- GoodCo can continue to pay its non-tort creditors in the ordinary course of its business and outside of a court-approved chapter 11 plan. By contrast, tort claimants trapped in BadCo's bankruptcy are not treated the same, as they are not getting paid, and it is not clear when, if ever, they will be.

- GoodCo need not respect the "absolute priority rule"; while tort creditors in BadCo's bankruptcy remain uncompensated, GoodCo can distribute its substantial earnings to its direct and indirect parent companies and shareholders, which effectively renders GoodCo "cash-poor" while it is allegedly on the hook to pay BadCo under the funding agreement. And in bankruptcy, all creditors are supposed to be paid before shareholders.

In addition, the funding agreement has been engineered to prevent the tort creditors and their representatives in BadCo's bankruptcy from proposing a competing chapter 11 plan when exclusivity ends, because GoodCo is not obligated to fund a victim compensation trust under the plan unless GoodCo approves of that plan and receives permanent injunctive protection when BadCo exits chapter 11.

As a result, almost all of AceCo's former assets are outside the bankruptcy court's jurisdiction, and GoodCo is not subject to the obligations and creditor protections that are required of a chapter 11 debtor. The normal economic pressures and incentives that motivate corporate debtors to come to the negotiating table in good faith and attempt to quickly achieve a fair bargain with their creditors in the form of a consensual chapter 11 plan do not exist as a result of the Texas Two-Step,[14] nor would a corporation need to resort to the Texas Two-Step if that were its intention.

Moreover, GoodCo thereby evades the quarterly bankruptcy fees that are owed to the U.S. government under 28 U.S.C. § 1930(a)(6) and (7), because such fees are tied to the amount of the assets entering bankruptcy.

Without the normal economic incentives and pressures that encourage a debtor to make a seasonable exit from chapter 11, BadCo can idle in chapter 11 as long as it wants, with little downside due to the stay of tort litigation against its enterprise group, and can thus delay the resolution of its chapter 11 case until the tort creditors knuckle under and agree to a substantial discount on the value or recovery of their claims. This is not a normal chapter 11 process; it is a perversion of that process.

Additionally, the Texas divisional merger law was not intended as a device to disadvantage creditors. Through the use of the Texas Two-Step, the Texas legislature made a conscious decision to include a provision in the Texas Business Organizations Code—section 10.901—that preserves all "rights of . . . creditor[s] under existing laws," notwithstanding any other provision in that Texas code, including the divisional merger provisions.[15] Moreover, the legislative history of the Texas statute confirms that, even with the divisional merger law in place, "creditors would continue to have the protections provided by the Uniform Fraudulent Transfer Act and other existing statutes that protect the rights of creditors."[16]

Congress Should Address the Divisional Merger Problem with Legislation

Without direct congressional action, there is no assurance that these divisional-merger schemes will stop.[17] Since the first one was filed in 2017, the number of such cases has snowballed. A total of five divisional-merger schemes have now been implemented, and have led to chapter 11 cases that all remain pending. This state of affairs has saved those wealthy corporations many

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[14] For example, GoodCo need not assure lenders and bondholders that it will move through the chapter 11 process speedily and need not take steps to assure suppliers and vendors that it will abide by the previous payment terms for post-filing trade debt.

[15] TEX. BUS. ORGS. CODE § 10.901.

[16] CHRISTOPHER J. BABCOCK & KEVIN A. CHUMNEY, *H.B. 472. Bill Analysis of H.B. 472 of the 71st Legislature (1989)* § 26, *in* O'CONNOR'S BUSINESS ORGANIZATIONS CODE PLUS.

[17] Fraudulent transfer actions and similar claims take a long time to pursue, are fact-intensive, require extensive discovery, and there could be no assurance that such claims will ultimately be successful. *See Double Eagle Club, Inc. v. Genovese*, No. CV 117-073, 2019 WL 2151367, at *2 (S.D. Ga. Apr. 4, 2019) (the "fact intensive" fraudulent transfer analysis "require[s] broad and deep discovery" on multiple factors); *In re Soup Kitchen Int'l Inc.*, 506 B.R. 29, 43 (Bankr. E.D.N.Y. 2014) (approving settlement and avoiding the "strong likelihood of complex, protracted, and expensive litigation" posed by rejecting settlement and requiring parties to litigate fraudulent transfer action); *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 480 B.R. 501, 521 (Bankr. S.D.N.Y. 2012) (noting the inevitability of "protracted, expensive litigation" if creditors were required to bring avoidance action to recover fraudulent transfers).

millions of dollars, while leaving their mass-tort victims out in the cold. As a result, more divisional-merger schemes are likely underway, which will lead to more abusive chapter 11 filings. The Texas Two-Step is a clear and obvious abuse of the bankruptcy process.

While a comprehensive analysis of all of the potential legislative fixes are beyond the scope of my testimony here today, there are a number of alternatives that Congress can consider. For example, Congress could limit the duration of a bankruptcy court's stay or injunction of litigation against the debtor's nonbankrupt affiliates to no more than 60 days, to incentivize the "BadCo" and "GoodCo" entities to begin good-faith negotiations with their disfavored creditors in earnest, and to limit the harm to the innocent tort victims. Congress could also amend the Bankruptcy Code to provide for the dismissal of any chapter 11 case that was preceded by a divisional merger, which would likely deter the Texas Two-Step from occurring in the first place. The critical point is that Congress should act now to provide much-needed reform and protection for creditors in this area and to clarify and reaffirm the essential debtor-creditor balance that it crafted 43 years ago.

APPENDIX: DIVISIONAL-MERGER CASE STUDIES

I. GEORGIA-PACIFIC

Georgia-Pacific LLC ("GP") is a high-value company. When Koch Industries acquired GP in 2005, the acquisition was valued at $21 billion.[18] GP and its affiliates were a multibillion-dollar enterprise behind several major paper product brands.[19] GP also had substantial asbestos liabilities associated with some of its products.[20]

In 2017, GP converted from a Delaware company to a Texas company.[21] As a Texas company, GP made use of the Texas divisional merger law and separated into two new entities: one with limited assets and the other with most of the remaining assets of "old" GP.[22] The company with limited assets became Bestwall LLC ("Bestwall"), holding approximately $175 million in assets as well as *all* of GP's asbestos liabilities,[23] which is estimated to be in the billions of dollars.[24] The entity that received almost all of "old" GP's assets retained GP's name (*i.e.*, Georgia-Pacific LLC). Within a matter of hours after the divisional merger was implemented, GP converted back to a Delaware company, and Bestwall converted to a North Carolina company.[25]

As part of the divisional merger, "new" GP and Bestwall entered into a funding agreement whereby GP promised to provide funds to Bestwall, if necessary, including funds necessary for a chapter 11 reorganization.[26] Among other problematic features of this transaction, no collateral is securing GP's obligation to pay Bestwall under the funding agreement.[27] And the funding agreement does not preclude GP from transferring substantially all of its assets or otherwise disposing of its valuable business.[28]

Less than four months later, Bestwall filed its chapter 11 petition with the U.S. Bankruptcy Court for the Western District of North Carolina.[29] As a result of the filing, asbestos lawsuits and other creditor actions against Bestwall were automatically stayed. The same day, Bestwall moved to enjoin asbestos lawsuits against affiliates that did not file for bankruptcy, including GP. Over the objection of the asbestos claimants' representatives, the bankruptcy court granted the injunctive

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[18] Koch's Philosophy of Philanthropy, https://news.kochind.com/CMSPages/GetFile.aspx?guid=4c2feb6b-6a22-4df2-97c8-984f611c9e4b (last visited Feb. 2, 2022).

[19] *Id.*; *see* Declaration of Tyler L. Woolson in Support of First Day Pleadings ¶ 13, *In re Bestwall LLC*, No. 17-31795 (Bankr. W.D.N.C. Nov. 2, 2017), ECF No. 2 ("Woolson Decl.").

[20] *See* Woolson Decl. ¶¶ 26-29.

[21] *See id.* ¶ 17 (explaining steps of GP's divisional merger).

[22] *See id.* ¶¶ 17-18.

[23] *See id.* ¶ 18.

[24] *See* Brief of Appellant Official Committee of Asbestos Claimants of Bestwall LLC, at 3, 9, *In re Bestwall LLC*, No. 3:20-cv-00103 (W.D.N.C. Apr. 15, 2020), ECF No. 6.

[25] *See id.* ¶ 17.

[26] *See* Woolson Decl. ¶ 20.

[27] *See generally id.* annex 2 (Second Amended and Restated Funding Agreement).

[28] *See id.* ¶ 4(b)(i).

[29] GP's divisional merger was executed on July 21, 2017, and Bestwall filed chapter 11 on November 2, 2017. *See* Woolson Decl. ¶¶ 5, 17.

relief and three years later the district court affirmed.[30] On August 15, 2018, a motion to dismiss the bankruptcy was filed, but was later denied by the bankruptcy court. To this day, the nearly five-year long injunction shielding GP and other nonbankrupt affiliates remains in place.

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[30] *See In re Bestwall LLC*, 606 B.R. 243 (Bankr. W.D.N.C. 2019), *aff'd*, No. 3:20-CV-105-RJC, 2022 WL 68763 (W.D.N.C. Jan. 6, 2022).

II. CERTAINTEED

CertainTeed Corporation ("CertainTeed") was part of a large, multinational, and multibillion-dollar building products conglomerate, and it faced significant legacy tort liabilities to individuals harmed by its asbestos-containing products.[31] CertainTeed had spent billions of dollars to defend and resolve the hundreds of thousands of asbestos lawsuits filed against it over the past 20 years.[32]

To address its legacy asbestos liabilities and prepare the way for a chapter 11 filing, CertainTeed engaged in a divisional merger under Texas law in October 2019.[33] CertainTeed first converted from a Delaware corporation to a Delaware limited liability company known as CertainTeed LLC ("CT"). The next day, CT converted from a Delaware limited liability company to a Texas limited liability company. A half-hour later, CT engaged in the divisional merger, effectively splitting itself into two Texas limited liability companies: "new" CT and DBMP LLC ("DBMP"). In connection with the divisional merger, "new" CT received 97% of "old" CT's assets, while the remaining 3% of old CT's assets were allocated to DBMP.[34] DBMP also received all of "old" CT's asbestos liabilities.[35] "New" CT converted to a Delaware limited liability company, and DBMP converted to a North Carolina limited liability company. All told, CT and DBMP were Texas entities for less than four hours.[36]

As part of the divisional merger, "new" CT and DBMP entered into a "funding agreement" whereby CT promised to provide funds to DBMP, if necessary, including funds necessary for DBMP's eventual chapter 11 case.[37] Among other problematic features of this transaction, no collateral secured CT's obligation to pay DBMP under the funding agreement.[38] And the funding agreement did not preclude CT from transferring substantially all of its assets or otherwise disposing of its valuable business.[39]

Ninety-one days after completion of CT's divisional merger, DBMP filed its chapter 11 petition with the U.S. Bankruptcy Court for the Western District of North Carolina.[40] As a result of the filing, asbestos lawsuits and other creditor actions against DBMP were automatically stayed. The same day, DBMP moved to enjoin asbestos lawsuits against affiliates and distributors that did

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31 *See In re DBMP LLC*, No. 20-30080, 2021 WL 3552350, at *5-6 (Bankr. W.D.N.C. Aug. 11, 2021).

32 *Id.* at *6.

33 *See id.* at *8, *17.

34 *Id*. at *9.

35 *Id*.

36 The bankruptcy court's findings of fact regarding the steps of CertainTeed's divisional merger can be found at *DBMP LLC*, 2021 WL 3552350, at *8-10.

37 *See id.* at *9, *11.

38 *See id.* at *11-12.

39 *Id*. at *12.

40 *Id*. at *15.

not file for bankruptcy, including CT.[41] Over the objection of the asbestos claimants' representatives, the bankruptcy court "extended" the automatic stay and granted injunctive relief.[42]

The court did, however, note the following:

- "Old CertainTeed never entertained a bankruptcy filing for itself and all of its subsidiaries and affiliates (the "CertainTeed Enterprise"). This was a profitable going concern whose assets significantly outweighed its combined operating and asbestos liabilities."[43]

- "Old CertainTeed took advantage of a corporate restructuring procedure under Texas law to put all of its asbestos liabilities into one company, DBMP, and virtually all of its assets and all of its non-asbestos liabilities, into another, New CertainTeed. The Debtor's own documents describe the procedure as the '[s]plitting of CertainTeed legal entity . . . (Carving out two locations to isolate Asbestos liability).'"[44]

- "In sum, while the Funding Agreement may provide funding for a plan, it will do so only if New CertainTeed favors that Plan. And that favor is dependent on New CertainTeed receiving permanent injunctive relief from the DBMP Asbestos Claims—whether it is entitled to it or not."[45]

To this day, the injunction shielding CT and its other nonbankrupt affiliates remains in place.

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[41] *Id*. at *1.

[42] *See id.* at *1, *43.

[43] *DBMP LLC*, 2021 WL 3552350, at *8.

[44] *Id.* (alteration in original).

[45] *Id*. at *12.

III. INGERSOLL-RAND AND TRANE U.S.

Along with their affiliates and subsidiaries, Ingersoll-Rand Company ("IR") and Trane U.S., Inc. ("Trane") were global manufacturers of climate control products for buildings, homes, and transportation and were indirectly owned by the same parent holding company, Ingersoll-Rand plc, now known as Trane Technologies plc.[46] While IR and Trane were successful companies, holding billions of dollars of assets, they also faced significant asbestos liabilities arising from exposures to their asbestos-containing products.[47] To address those liabilities and prepare the way to put their asbestos liabilities into a chapter 11 bankruptcy without subjecting the vast majority of their assets to the jurisdiction of the bankruptcy court, IR and Trane each engaged in divisional mergers under Texas law.[48]

A. IR's Divisional Merger

IR first merged with and into a shell Texas limited liability company that had been formed the previous day. That same day, IR effected its divisional merger under Texas law, effectively dividing into two new Texas limited liability companies: Trane Technologies Company LLC ("TTC") and Aldrich Pump LLC ("Aldrich"). TTC received 99% of old IR's assets, while the remaining 1% of IR's assets were allocated to Aldrich.[49] Aldrich was also assigned all of IR's asbestos liabilities. Later that day, TTC converted to a Delaware limited liability company, and Aldrich converted to a North Carolina limited liability company. All told, TTC and Aldrich were Texas companies for less than 24 hours.[50]

B. Trane's Divisional Merger

While IR was undergoing its divisional merger, Trane was doing the same. Trane first converted from a Delaware corporation to a Texas corporation. That same day, Trane effected its Texas divisional merger, effectively splitting into two Texas entities: "new" Trane and Murray Boiler LLC ("Murray"). "New" Trane received 98% of "old" Trane's assets, while the remaining 2% of those assets were allocated to Murray.[51] Murray also received all of Trane's asbestos liabilities. Later that day, "new" Trane converted to a Delaware corporation, and Murray converted to a North Carolina limited liability company. All told, Trane and Murray were Texas entities for less than 24 hours.[52]

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[46] *In re Aldrich Pump LLC*, No. 20-30608 (JCW), 2021 WL 3729335, at *1, *4 (Bankr. W.D.N.C. Aug. 23, 2021).

[47] *See id*. at *6, *22.

[48] *Id.* at *9.

[49] *Id.* at *10.

[50] The bankruptcy court's findings of fact regarding the steps of IR's divisional merger can be found *In re Aldrich Pump LLC*, 2021 WL 3729335, at *10.

[51] *Id.* at *11.

[52] The bankruptcy court's findings of fact regarding the steps of Trane's divisional merger can be found *In re Aldrich Pump LLC*, 2021 WL 3729335, at *10-11.

C. Funding Agreements

As in the previous divisional mergers involving Bestwall and DBMP, Aldrich and Murray entered into separate funding agreements with TTC and Trane, respectively. Under the Aldrich-TTC funding agreement, TTC promised to provide funds to Aldrich, if necessary, including funds necessary for Aldrich's eventual chapter 11 case.[53] Similarly, under the Murray-Trane funding agreement, Trane promised to provide funds to Murray, if necessary, including funds necessary for Murray's eventual chapter 11 case.[54] As with the funding agreements used in the *Bestwall* and *DBMP* bankruptcies, the funding agreements for Aldrich and Murray contained several problematic features. For example, TTC's and Trane's respective funding obligations were not secured by any collateral, nor were they guaranteed by any other entity.[55] And the funding agreements did not prevent TTC and Trane from engaging in additional divisional mergers, and they explicitly allowed TTC and Trane to engage in consolidations and mergers, and to transfer all or substantially all of their assets to third-parties.[56] What is more, the funding agreements contained provisions that impair, if not effectively disable, the ability and right of other parties-in-interest to propose a competing chapter 11 plan once Aldrich's and Murray's exclusive right to propose a plan terminates.[57]

D. Chapter 11 Filings of Aldrich and Murray

Seven weeks after completing their respective divisional mergers, Aldrich and Murray filed their chapter 11 petitions with the U.S. Bankruptcy Court for the Western District of North Carolina and moved to enjoin asbestos lawsuits against affiliates (including TTC and Trane), insurers, and third parties, all of which had not filed for bankruptcy.[58] Over the objection of the current asbestos claimants' representatives, the bankruptcy court "extended" the automatic stay and granted injunctive relief.[59]

The court did, however, note the following:

- "***Old IRNJ and Old Trane never entertained a bankruptcy filing for themselves and all of their subsidiaries and affiliates*** (the "Trane Enterprise"). This was a profitable going concern whose assets significantly outweighed its combined operating and asbestos liabilities."[60]

- "Meanwhile, Project Omega team members expected and planned for a long-term bankruptcy prior to the 2020 Corporate Restructuring, which they estimated would last for five or more years."[61]

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53 *Id.* at *12.

54 *Id.*

55 *Id*. at *14.

56 *Id*.

57 *Id*.

58 *Id*. at *1.

59 *In re Aldrich Pump LLC*, 2021 WL 3729335, at *2, *38.

60 *Id*. at *8-9 (emphasis added).

61 *Id*. at *9.

- "The 2020 Corporate Restructuring and the Divisional merger were undertaken so that the Trane Enterprise might obtain the injunctive benefits of an asbestos bankruptcy plan and trust without filing themselves."[62]

- "Rather, ***these bankruptcies were designed to isolate the asbestos claimants*** from the overall corporate enterprise ***and strand them in bankruptcy*** until such time as they agree to a Section 524(g) plan."[63]

To this day, the injunction shielding TTC, Trane, and their other nonbankrupt affiliates remains in place.

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62 *Id*. at *21.

63 *Id*. (emphasis added).

IV. JOHNSON & JOHNSON

Johnson & Johnson Consumer Companies, Inc. ("J&J Consumer") was part of the Johnson & Johnson enterprise group. In 2021, *Fortune* magazine noted Johnson & Johnson[64] had a market value of over $434 billion.[65]

J&J Consumer, a New Jersey company, manufactured and sold a wide variety of consumer health products.[66] J&J Consumer also faced mounting tort liabilities arising from its baby powder and cosmetic talc products.[67] As of October 2021, J&J Consumer had been named as a defendant in tens of thousands of lawsuits, including multidistrict litigation pending in the U.S. District Court for the District of New Jersey.[68]

In October 2021, J&J Consumer engaged in a divisional merger under Texas law.[69] To utilize the Texas divisional merger law, J&J Consumer converted to a Texas limited liability company. J&J Consumer then effectively divided itself into two new companies: Chenango One LLC ("Chenango One") and Chenango Two LLC ("Chenango Two"). Chenango One received assets and holdings valued at approximately $373 million, while also receiving the entirety of J&J Consumer's tort liabilities, estimated to be in the billions of dollars.[70] That same day, Chenango One converted to a North Carolina company and changed its name to LTL Management LLC ("LTL").

Chenango Two, on the other hand, received all of J&J Consumer's remaining assets (worth approximately $15 billion) and other liabilities.[71] Later that day, Chenango Two merged with and into a New Jersey entity formed the previous day, and the surviving merged entity changed its name to Johnson and Johnson Consumer Inc. ("new J&J Consumer"). New J&J Consumer is the direct parent of LTL and manufactures and sells the same broad range of products used in the baby care, beauty, and consumer health care fields as the former J&J Consumer.

As with the other entities that previously engaged in Texas divisional mergers, new J&J Consumer and LTL entered into an unsecured funding agreement that purports to provide LTL with certain funds (if necessary), including funds necessary for LTL's chapter 11 case.[72]

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[64] Johnson & Johnson is the New Jersey company incorporated in 1887 that was the ultimate parent of J&J Consumer.

[65] https://fortune.com/company/johnson-johnson/worlds-most-admired-companies/ (last visited Feb. 2, 2022). Indeed, Johnson & Johnson is one of only two U.S. companies with a AAA credit rating, which is higher than the credit rating of the U.S. government. *See* https://www.thestreet.com/markets/johnson-johnson-break-up-may-put-triple-a-credit-rating-at-risk (last visited Feb. 2, 2022).

[66] *See* Declaration of John K. Kim in Support of First Day Pleadings ¶ 19, *In re LTL Mgmt. LLC*, No. 21-30589 (Bankr. D.N.J. Oct.14, 2021), ECF No. 5 ("Kim Decl.").

[67] *Id.* ¶ 31.

[68] *Id.* ¶ 42.

[69] *See id.* ¶¶ 22-23 (explaining steps of J&J Consumer's divisional merger).

[70] *See id.* ¶¶ 26, 28.

[71] *Id.* ¶ 25; *see* Exhibit E to the Debtor's Objection to Motions to Dismiss Chapter 11 Case, *In re LTL Mgmt. LLC*, No. 21-30589 (Bankr. D.N.J. Dec. 22, 2021), ECF No. 956-6.

[72] *See* Kim Decl. ¶ 27; *see also generally id.* at Annex 2 (Amended and Restated Funding Agreement).

Two days after its formation, LTL filed its chapter 11 petition with the U.S. Bankruptcy Court for the Western District of North Carolina.[73] Shortly thereafter, LTL sought to stay tort litigation against its affiliates that did not file for bankruptcy, including new J&J Consumer.[74] The North Carolina bankruptcy court granted the stay for a brief period in light of the fact that it had ordered LTL's chapter 11 case to be transferred to the U.S. Bankruptcy Court for the District of New Jersey.[75] The merits of LTL's efforts to extend the litigation stay to its non-debtor affiliates remain pending in a New Jersey bankruptcy court, though the court recently extended the temporary stay to February 28, 2022, while a motion to dismiss that bankruptcy remains pending.[76]

In its order transferring venue to the District of New Jersey, the North Carolina bankruptcy court noted that LTL "may have assets, but they were all created to effectuate a bankruptcy filing and have ***no other business purpose***."[77]

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[73] J&J Consumer's divisional merger was implemented on October 12, 2021, and LTL filed chapter 11 on October 14, 2021. *See* Kim Decl. ¶¶ 5, 23.

[74] LTL filed its complaint on October 21, 2021. *See* Debtor's Complaint for Declaratory and Injunctive Relief (I) Declaring that the Automatic Stay Applies to Certain Actions Against Non-Debtors or, (II) Preliminarily Enjoining Such Actions and (III) Granting a Temporary Restraining Order Pending a Final Hearing, *LTL Mgmt. LLC v. Those Parties Listed on Appendix A to Complaint*, Adv. Pro. No. 21-03032-MBK (Bankr. D.N.J. Oct. 21, 2021), ECF No. 1.

[75] *See* Order Granting the Debtor's Request for Preliminary Injunction, *LTL Mgmt. LLC v. Those Parties Listed on Appendix A to Complaint*, Adv. Pro. No. 21-03032-MBK (Bankr. D.N.J. Nov. 15, 2021), ECF No. 102.

[76] *See* Bridge Order Extending Termination Date of Order Granting the Debtor's Request for Preliminary Injunctive Relief, *LTL Mgmt. LLC v. Those Parties Listed on Appendix A to Complaint*, Adv. Pro. No. 21-03032-MBK (Bankr. D.N.J. Jan. 15, 2022), ECF No. 157.

[77] *In re LTL Mgmt. LLC*, No. 21-30589, 2021 WL 5343945, at *6 (Bankr. W.D.N.C. Nov. 16, 2021) (emphasis added).