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Commercial: Boardroom Issues When Considering the "Texas Two-Step" and Proposing Third-Party Releases in a Bankruptcy Plan

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CONCURRENT SESSION

2022

Merger Definition

- The Texas Business Code defines "merger" as
  - (A) The division of a domestic entity into wo or more new domestic entities or other organizations or into a surviving domestic entity and one or more new domestic or foreign entities or non-code organizations; or
  - (B) the combination of one or more domestic entities with one or more domestic entities or non-code organizations resulting in:
    - (i) one or more surviving domestic entities or non-code organizations
    - (ii) the creation of one or more new domestic entities or non-code organizations; or
    - (iii) one or more surviving domestic entities or non-code organizations and the creation of one or more domestic entities or non-code organizations.

Tex. Bus. Orgs. Code §1.002(55).

Texas Two-Step is a Hot Topic in the Bankruptcy World

Judge Knocks 3M Bankruptcy Strategy for Military Earplug Lawsuits

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Country Dancing in the Bankruptcy Court: The "Texas Two-Step"

June 1, 2022

Pratt's Journal of Bankruptcy Law

By Michael Lichtenstein, Bankruptcy, Restructuring & Creditors' Rights

Past Event

Texas Two-Step of Tort Liability (J&J)

American Bankruptcy Institute Annual Spring Meeting

Pending Texas Two-Step Cases

Bestwall, LLC
Case No. 17-31795
(Bankr. W.D.N.C.)

DBMP, LLC
Case No. 20-30080
(Bankr. W.D.N.C.)

Aldrich Pump, LLC *et al*
Case No. 20-30608
(Bankr. W.D.N.C.)

LTL Management, LLC
Case No. 21-30589
(Bankr. D.N.J.)

Bestwall,LLC Case No: 17-31795

- As of the Petition Date, there were approximately 64,000 asbestos-related claims pending against the Debtor.
- In September 2020, the court approved a settlement whereby Georgia-Pacific agreed to fund the section 524(g) trust with $1 billion to resolve asbestos claims.
- In January 2022, Judge Conrad, the District Court Judge for the Western District of North Carolina issued an opinion denying the asbestos claimants committee's and future claimants' representative's appeal regarding the bankruptcy court's issued preliminary injunction.

DBMP, LLC Case No: 20-30080

- As of the Petition Date, the Debtors had more than 60,000 asbestos-related claims and associated lawsuits pending in jurisdictions across the United States.
- On August 23, 2021, the official committee of asbestos personal injury claims filed a motion to substantively consolidate the Debtor's estate with the assets of CertainTeed and a motion to seek derivative standing to prosecute causes of actions on behalf of the Debtors.
- February 2022, Judge Whitley denied the Debtors motion to dismiss the substantive consolidation motion.

Aldrich Pump—Case No. 20-30608

- As of the Petition Date, the Debtors had roughly 80,000 asbestos claims pending.
- In January 2021, Judge Whitley set the case on a duel estimation/litigation path.
- Judge Whitley approved the debtors' request to begin an asbestos estimation proceeding.
- Judge Whitley granted the asbestos claimant committee derivative standing to bring claims to challenge the divisional mergers that created the debtors including substantive consolidation.

LTL Management— Case No. 21-30589

- As of the Petition Date, the Debtors had approximately 38,000 ovarian cancer cases pending and more than 430 mesothelioma cases pending.
- The case was originally filed in the Western District of North Carolina. On November 16, 2021, the court entered an order transferring the case to the District of New Jersey.
- On September 19, 2022, the Third Circuit will hear oral arguments on the appeals of the bankruptcy court's rulings denying motion to dismiss the case and imposing a preliminary injunction shielding non-debtor affiliates, including Johnson & Johnson.

Recent Decisions—LTL Management, LLC, 21-30589 [Dkt No. 1572]

FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT DISTRICT OF NEW JERSEY **Caption in Compliance with D.N.J. LBR 9004-2(c)**	Case No. 21-30589 (MBK) Chapter 11 Hearing Date: February 14-18, 2022 Judge: Michael B. Kaplan, Chief Judge
In re: LTL MANAGEMENT, LLC, Debtor.	

All Counsel of Record

MEMORANDUM OPINION

Recent Decisions—LTL Management, LLC, 21-30589 [Dkt No. 1572]

- Judge Kaplan denied the Official Committee of Talc Claimants and other related parties motion to dismiss the debtor's bankruptcy case pursuant to Section 1112(b) of the Bankruptcy Code on the basis that the case was not filed "in good faith."
- Court noted that "this Court holds a strong conviction that the bankruptcy court is the optimal venue for redressing the harms of both present and future talc claimants in this case—ensuring a meaningful, timely, and equitable recovery."
- Court held that "the filing of a chapter 11 case with expressed aim of addressing the present and future liabilities associated with ongoing global personal injury claims to preserve corporate value is unquestionably a proper purpose under the bankruptcy code."
- The Official Committee of Talc Claimants have been granted a direct appeal to the Third Circuit.

Benchnotes

By Christina Sanfelippo, Patrick A. Clisham and Aaron M. Kaufman

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SDNY Finds No Statutory Authority for Third-Party, Nonconsensual Releases of Direct Claims

The U.S. District Court for the Southern District of New York recently ruled that the Bankruptcy Code does not authorize a bankruptcy court to order the nonconsensual release of third-party direct claims against nondebtors in connection with the confirmation of a chapter 11 plan.[1] In so holding, the court vacated confirmation of the debtors' reorganization plan.

The plan in *In re Purdue Pharma LP* provided for broad releases of particularized or direct claims — including claims predicated on fraud, misrepresentation and willful misconduct under various state consumer protection statutes — to all members of the Sackler families, as well as a variety of trusts, partnerships and corporations associated with the family and the people who run and advise those entities (the "shareholder releases").[2] The court was careful to reiterate that the claims at issue under the shareholder releases were *not* derivative claims. Accordingly, the court's findings speak to a very narrow range of claims that might be asserted against the Sacklers.

In concluding that it was statutorily authorized to approve the shareholder releases, the bankruptcy court relied on §§ 105(a), 1123(a)(5) and (b)(6), and 1129 of the Bankruptcy Code, together with its "residual authority."[3] On appeal, the district court found that the Code sections relied on by the bankruptcy court, whether read separately or together, do not confer any substantive right to approve the nonconsensual release of nonderivative third-party claims against nondebtors.[4] Rather, each of the cited sections confers on the bankruptcy court *only* the power to enter orders that carry out other, substantive Code provisions. Notably, the district court reviewed the shareholder releases *de novo* because it concluded that the bankruptcy court lacked authority to give final approval to those releases, even though they were incorporated into a reorganization plan.[5]

After an extensive survey of Second Circuit precedent on the subject of nonconsensual, third-party releases of direct claims, the district court determined that § 105(a), standing alone, does not confer authority on the bankruptcy court to approve the shareholder releases.[6] Section 105(a) does not authorize a bankruptcy court "to create substantive rights that are otherwise unavailable under applicable law."[7] Rather, it confers on the bankruptcy court only the power to enter orders that carry out other substantive Code provisions. The district court concluded that the authority to approve the shareholder releases must ultimately derive from some other Code provision.[8]

Turning to the remaining Code provisions cited by the bankruptcy court, the district court found § 1123(b)(6), which authorizes a plan to "include any other appropriate provision not inconsistent with the applicable provisions of this title," to be substantively analogous in form to § 105(a). As a result, the district court reasoned that § 1123(b)(6) cannot be read to confer any substantive authority on the bankruptcy court.[9] The district court also noted that certain aspects of the shareholder releases violated § 1123(b)(6) because those aspects were inconsistent with other Code provisions.[10] The shareholder releases granted releases to nondebtors for claims — such as claims for fraud or willful and malicious conduct or claims for civil penalties payable to and for the benefit of governmental units — that could not be released in favor of the debtors themselves.

The district court similarly found that § 1123(a)(5), which provides that a reorganization plan must provide adequate means for its implementation, does not confer a substantive right.[11] Relying on *Dairy Mart*, the district court rejected the notion that since the debtors required funding to implement the plan, and that funding could only be obtained from the Sacklers on condition of a release and an injunction, the release and injunction were authorized under § 1123(a)(5).[12] Section 1123(a)(5) does not authorize a court to give its approval to something that the Bankruptcy Code does not otherwise authorize simply because doing so would ensure funding for a plan. Finally, the district court found no authority under § 1129(a)(1) for the approval of the shareholder releases, because § 1129(a)(1) is simply another highly general provision.[13]

After concluding that no statutory authority exists for the approval of the shareholder releases, the district court considered the debtors' argument that the bankruptcy court had statutory authority to approve the releases because no Code provision expressly prohibits them. The district court rejected the debtors' argument on several grounds.

1 *In re Purdue Pharma LP*, No. 21 CV 7532 (CM), 2021 WL 5979108(S.D.N.Y. Dec. 16, 2021), certificate of appealability granted, No. 21 CV 7532 (CM), 2022 WL 121393 (S.D.N.Y. Jan. 7, 2022). *See also* Paul R. Hage, "'The Great Unsettled Question': Nonconsensual Third-Party Releases Deemed Impermissible in *Purdue*," XLI *ABI Journal* 2, 12-13, 43-45, February 2022, *available at* abi.org/abi-journal.
2 *Purdue* at *48.
3 *Id.* at *35.
4 *Id.* at *62.
5 *Id.* at *39.
6 *Id.* at *60.
7 *Id.* at *56 (citing *New England Dairies Inc. v. Dairy Mart Convenience Stores Inc. (In re Dairy Mart Convenience Stores Inc.)*, 351 F.3d 86, 92 (2d Cir. 2003)).
8 *Id.* at *61.
9 *Id.* at *62.
10 *Id.*
11 *Id.* at *64.
12 *Id.* (citing *Dairy Mart*, 351 F.3d at 92).
13 *Id.* at *65.

First, the notion that statutory authority can be inferred from congressional silence is inconsistent with the comprehensiveness of the Code's federal bankruptcy scheme.[14] Second, the district court explained that it did not expect Congress to have thought it necessary to expressly forbid the types of releases found in the shareholder releases because if the nondebtors were debtors in their own cases, the bankruptcy court would be barred from authorizing the very same releases under the Code.[15] Third, the district court rejected the contention that Congress has been silent on the subject of nonconsensual, third-party releases, noting that Congress enacted § 524(g) and (h) and elected to limit Code-based authority to release third-party claims against nondebtors to asbestos litigation.[16] Finally, under the general/specific cannon of statutory construction, the general Code provisions relied upon by the bankruptcy court cannot be used to expand the specific authority to order releases conferred by Congress under § 524(g).[17]

The final argument considered by the district court was whether the shareholder releases were authorized under the bankruptcy court's residual authority. The district court concluded that "residual statutory authority" does not exist and that the bankruptcy court's equitable powers can only be exercised within the confines of the Bankruptcy Code.[18]

Miscellaneous

• *In re Robinson*, --- B.R. ---, 2021 WL 3713850 (Bankr. D. Kan. 2021) (bankruptcy court overruled objection by U.S. Trustee to confirmation of a subchapter V reorganization plan, arguing that plan was not consensual plan under 11 U.S.C. § 1191(a), as all classes of creditors were impaired but no creditors voted on plan; bankruptcy court found that under Tenth Circuit precedent in *In re Ruti-Sweetwater Inc*., 836 F.2d 1263 (10th Cir. 1988), non-objecting and non-voting creditor is deemed to have accepted reorganization plan for purposes of satisfying 11 U.S.C. § 1129(a)(8) and avoiding cramdown requirements of § 1129(b)(1), but such deemed acceptance does not constitute "actual acceptance" requirement of at least one class of claims under § 1129(a)(10); in context of subchapter V case, however, bankruptcy court found that requirement of satisfying § 1129(a)(10) would be superfluous given satisfaction of § 1129(a)(8) under Tenth Circuit's holding in *Sweetwater*; as a result, plan could be confirmed as consensual plan under § 1191(a));

• *In re Steen*, --- B.R. ---, 2021 WL 2877515 (Bankr. N.D. Tex. 2021) (bankruptcy court found that attorney's services in connection with defending chapter 13 debtor in nondischargeability proceeding were beneficial and necessary to debtors' estate or debtors, as required for fees to be compensable; according to bankruptcy court, dischargeability complaint was core bankruptcy matter, challenging most basic benefit sought by individuals in bankruptcy that had to be resolved);

• *In re Dean*, --- F.4th ---, 2021 WL 5801273 (5th Cir. Dec. 7, 2021) (court of appeals dismissed appeal by individual chapter 7 debtor because bankruptcy court's order approving chapter 7 trustee's litigation funding agreement with creditor "does not affect whether [the debtor's] debts will be discharged;" accordingly, court concluded that debtor lacked bankruptcy standing to appeal order, as he could not show how funding agreement would "directly, adversely, and financially impact him");

• *In re 461 7th Ave. Market Inc*., 2021 WL 5917775 (2d Cir. Dec. 15, 2021) (court of appeals affirmed denial of stay pending appeal of bankruptcy court's order converting chapter 11 case to chapter 7; district court properly held that appellee made "strong showing" of success on merits given that "there was no real factual dispute as to whether [the debtor] had the financial ability to make the alterations necessary to assume the lease"; without ability to assume lease, reorganization was futile; based on these findings, district court did not err in concluding that appellee was likely to succeed on appeal, and bankruptcy court did not violate debtor's due-process rights by ruling without evidentiary hearing given the lack of genuine factual dispute);

• *Dillworth v. Diaz (In re Bal Harbour Quarzo LLC)*, --- B.R. ---, 2021 WL 5753708 (Bankr. S.D. Fla. Dec. 3, 2021) (court granted motion to dismiss, with leave to amend, concluding that complaint failed to allege plausible bases to avoid fraudulent transfers made by nondebtor entities and beyond general four-year lookback period; specifically, plaintiff did not allege that defendants were bound by a certain state court default order finding nondebtor transferors to be debtor's alter-ego, nor did plaintiff affirmatively allege "plausible substantive allegations" that would give rise to a finding that nondebtor transferors were, in fact, debtor's alter-ego under Florida law; for older transfers, plaintiff failed to identify "triggering creditor" that would have had standing to avoid transfers outside of four-year lookback period under Florida law; thus, court granted motion to dismiss, in part, with leave to amend);

• *In re Legare-Doctor*, --- B.R. ---, 2021 WL 5712149 (Bankr. D.S.C. Dec. 1, 2021) (Bankruptcy Rule 3002.1 applies to reverse mortgages in chapter 13 cases, particularly where secured creditor asserts secured claim for advances made to pay debtor's delinquent taxes and insurances; secured creditor sought repayment for these advances but did not comply with disclosure requirements under Rule 3002.1(c); such violation caused harm to chapter 13 debtor by forcing debtor to respond to motion for stay relief and amend plan to account for undisclosed advances; court held that special remedies under Rule 3002.1(i) were warranted; specifically, court precluded secured creditor from asserting claim for advances in present chapter 13 case *and* from collecting advances from debtor after debtor obtained § 1328 discharge; court also awarded attorneys' fees);

• *In re Rickerson*, --- B.R. ---, 2021 WL 5905974 (Bankr. W.D. Pa. Dec. 14, 2021) (individual chapter 11 debtor did not qualify for subchapter V designation because she failed to carry her burden of proving eligibility under 11 U.S.C. § 1182(1)(A), which required her to show that she was "engaged in commercial or business activities" and had

continued on page 54

14 *Id.*
15 *Id.* at *66.
16 *Id.*
17 *Id.* at *67-68.
18 *Id.* at *68-69.

Benchnotes

from page 7

"aggregate noncontingent liquidated secured and unsecured debts ... not less than 50 percent of which arose from the commercial or business activities"; although debtor previously owned businesses, there was no dispute that she ceased those business activities long before her petition date and was now W-2 employee for third-party company that she did not own; court also concluded that debtor failed to prove that 50 percent of her debts arose from business or commercial activities; in particular, court was not persuaded, based on record presented, that debtor's personal income taxes incurred as W-2 employee or independent contractor constituted debts arising from commercial or business activities);

• *In re Vrusho*, --- B.R. ---, 2021 WL 5762941 (Bankr. D.N.H. Dec. 3, 2021) (court denied creditor's motion to extend bar date under Bankruptcy Rule 3003(c) in chapter 13 case; not only was creditor's motion untimely — well after the 60 days required by Bankruptcy Rule 3002(c)(6) — but court found that debtor's notice to creditor's collection attorney was sufficient to impute notice on creditor because attorney was directly involved in collection of claim at issue in bankruptcy case; creditor's willful disregard of its own attorney's prompt notification and 10-month delay in seeking to file late claim lent further support to court's decision to deny creditor's motion to extend bar date);

• *Lowry v. Southfield Neighborhood Revitalization Initiative, et al. (In re Lowry)*, No. 20-1712, 2021 WL 6112972 (6th Cir. Dec. 27, 2021) (Sixth Circuit reversed lower courts' grant of summary judgment on complaint alleging that tax foreclosure could be avoided as constructively fraudulent transfer under § 548(a)(1)(B); court found that *Rooker-Feldman* doctrine did not apply to bar debtor's claim under § 548 to avoid tax foreclosure of his property because debtor's claim does not involve review of merits of state court foreclosure judgment, but instead involves whether tax foreclosure could be avoided as fraudulent transfer under § 548; Sixth Circuit also found U.S. Supreme Court's holding in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), that if foreclosing authority followed state law in mortgage foreclosure sale, sale price was the "reasonably equivalent value" of property for purposes of § 548, to be inapplicable because *BFP* involved mortgage foreclosure and Supreme Court explicitly limited its holding to mortgage foreclosures; Sixth Circuit reasoned that mortgage foreclosure sales are distinguishable from tax foreclosure sales in that mortgage foreclosure sale is at least somewhat correlated to property's value while tax foreclosure sale focuses on value of taxes owed); and

• *Skyline Restoration Inc. v. Church Mut. Ins. Co.*, 20 F.4th 825 (4th Cir. 2021) (Fourth Circuit held that creditor, as assignee of debtor's claims under remediation contract, could not utilize § 108(a) to toll limitations period for bringing unexpired legal claims; purpose of § 108(a) is to aid trustee and debtor-in-possession in carrying out their fiduciary duties to all creditors of bankrupt to recover assets for bankruptcy estate; Fourth Circuit reasoned that since assignee may act in its own self-interest to detriment of bankrupt's other creditors, permitting assignee to use tolling provision to bring its own claims would run counter to purpose of § 108(a)). abi

Faculty

Keith M. Aurzada is a partner with Reed Smith LLP in Dallas and advises public and private corporations, boards of directors and management teams regarding matters most important to their business. His industry experience includes representing companies involved in the technology industry, health care, real estate, retail, manufacturing, health spas, restaurants, and oil and gas. Mr. Aurzada has served as a court-appointed receiver in the Texas state and federal courts. He regularly assists clients on matters involving significant corporate transactions, the preservation of intellectual property, civil litigation and the restructuring of indebtedness (both in and out of court, including bankruptcy where necessary). He also has assisted his clients with numerous employment concerns relating to discrimination in both the administrative regulatory context and in court, as well as in other labor matters, including noncompetition agreements and the protection of trade secrets. Mr. Aurzada lectures frequently on a variety of topics before bar associations and professional organizations. He also recently served as an adjunct professor of law at the University of Wyoming. Mr. Aurzada has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law and Litigation - Bankruptcy for 2009-22, and was ranked in *Chambers USA* for Texas Bankruptcy/Restructuring in 2021. He received his B.S. in 1993 from the University of Wyoming and his J.D. with honors in 1996 from the University of Wyoming College of Law, were he was admitted to the Order of the Coif.

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