AMERICAN BANKRUPTCY INSTITUTE

Mid-Atlantic Bankruptcy Workshop

"They Did What?" Attacking Pre-Bankruptcy Transactions

Jeffrey N. Rothleder, Moderator
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Hon. Michael B. Kaplan
U.S. Bankruptcy Court (D. N.J.) | Trenton

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ArentFox Schiff LLP | Washington, D.C.

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Bond, Schoeneck & King PLLC | Syracuse, N.Y.

CONCURRENT SESSION

2022

"They Did What?" – Attacking Pre-Bankruptcy Transactions

The Honorable Michael J. Kaplan, Chief Judge, United States Bankruptcy Court for the District of New Jersey
Kristin K. Going, McDermott Will & Emery
Jackson D. Toof, ArentFox Schiff LLP
Grayson T. Walter, Bond, Schoeneck & King PLLC
Jeffrey N. Rothleder, Squire Patton Boggs (US) LLP, Moderator

Fraudulent Transfers

11 U.S.C. § 548

(a)(1) The trustee may avoid any transfer . . . of an interest of the debtor in property, or any obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily--

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 544 also provides the trustee with the status of a hypothetical lien creditor to bring avoidance actions under applicable state fraudulent conveyance laws.

Intentional Fraudulent Transfers – 11 U.S.C. § 548(a)(1)(A)

- Requires actual intent to hinder, delay, or defraud.
  - Debtor's insolvency and inadequacy of consideration are not requisite elements of a cause of action under § 548(a)(1)(A).
- Allegations of fraud must be pled with specificity and must relate to the challenged transfer. *In re Sharp Int'l Corp.*, 403 F.3d 43 (2d Cir 2005).
- Transferor's subjective intent is a factual question.
  - Generally inappropriate for summary judgment
  - Fraudulent intent may be inferred from the presence of "badges of fraud," including:
    - Transfers made in anticipation of actual or threatened litigation
    - Transfers made for inadequate consideration
    - Transfers made to insiders
    - Transferor retaining possession or control
    - Concealment of, or false pretenses for transfer
    - Secreting or absconding with proceeds of transfer
    - A suspect pattern or general chronology of transactions
- A corporation can only act through its officers and directors. For purposes of an intentional fraudulent transfer claim "a company's intent may be established only through the 'actual intent' of the individuals 'in a position to control the disposition of [the transferor's property." *In re Tribune Co. Fraud. Conv. Litigation*, 10 F.4th 147 (2d Cir. 2021).

Constructive Fraudulent Transfers – 11 U.S.C. § 548(a)(2)

- Debtor's actual intent is not determinative.
- Transfer of an interest of the debtor in property and absence of reasonably equivalent value are threshold elements.
  - Property of the debtor, for purposes of avoiding a prepetition transfer, includes property which, but for such transfer, would have been included in the debtor's bankruptcy estate pursuant to § 541 of the Bankruptcy Code. *Begier v. I.R.S.*, 496 U.S. 53 (1990).
  - Bankruptcy Code does not define "reasonably equivalent" but does define "value" for purposes of section 548 as "property, or satisfaction or securing of a present or antecedent debt of the debtor" but not "an unperformed promise to furnish support to the debtor or a relative of the debtor."
    - Whether a debtor receives reasonably equivalent value is a mixed question of law and fact.
    - The value received by a debtor can be direct or indirect, but transactions that do not confer an economic benefit on the debtor will generally not support a finding of reasonably equivalent value. *In re Rodriguez*, 895 F.2d 725 (11th Cir. 1990).
- Under § 548(a)(2)(B)(ii)(I) the party challenging the transaction must show that debtor was insolvent, or rendered insolvent at the time of the challenged transaction.
  - No presumption of insolvency. *Matter of Southmark*, 88 F.3d 311 (5th Cir. 1996).
  - Courts will apply a "balance sheet" test to determine if debtor's assets exceed liabilities. *Universal Church v. Geltzer*, 463 F.3d 218 (2d Cir. 2006).
    - Contingent liabilities should be discounted by the probability the liability will become real. *Matter of Xonics Photochemical, Inc.*, 841 F.2d 198 (7th Cir. 1988).

Committee derivative standing

- Majority of courts (including the 2d, 3d, 4th, 5th, 9th and 11th Circuits) have found an "implied, but qualified" right for a committee to obtain standing, with bankruptcy court approval, to pursue avoidance actions on behalf of the estate.
    - Committee must first articulate "a colorable claim or claims for relief that on appropriate proof would support a recovery." *In re STN Enterprises, Inc.*, 779 F.2d 901 (2d Cir. 1985).
        - Standard for assessing whether a claim is "colorable" is akin to that applied to evaluate a motion to dismiss for failure to state a claim. *In re Sabine Oil & Gas Corp.*, 562 B.R. 211 (S.D.N.Y. 2016).
    - If colorable claims exist, bankruptcy courts may confer standing upon committees if the debtor/trustee unjustifiably refuses to bring suit, or consents to the committee doing so on its behalf and the court finds that such standing is in the best interest of the estate and necessary and beneficial to the resolution of the case. *In re Commodore International, Ltd.*, 262 F.3d 96 (2d Cir. 2001).
        - Formal demand that the debtor bring an action may not be necessary where it would be futile. *In re G-I Holdings, Inc.*, 313 B.R. 612 (Bankr. D. N.J. 2004).

    - To evaluate whether a debtor has unjustifiably refused to bring an action the court must conduct an analysis of a derivative action's likelihood of success, expected cost, and anticipated recovery, but is not required to conduct a "mini-trial."
        - The committee need not show a likelihood of success on the merits of its claims, but must "give the Court comfort that their litigation will be a sensible expenditure of estate resources. *In re Adelphia Comm's Corp.*, 330 B.R. 364, (Bankr. S.D.N.Y. 2005).
        - Additional factors to be considered can include:
            - Whether the debtor has a conflict of interest
            - Whether creditors' interests are protected despite the debtor's refusal
            - Whether allowing the committee to pursue the action will benefit the estate
            - Whether it would be preferable to appoint a trustee to pursue the action
- A grant of derivative standing is not necessarily exclusive and may be withdrawn. *In re Adelphia Comm's Corp*., 544 F.3d 420 (2d Cir. 2008) – plan may assign litigation claims to post-confirmation trust notwithstanding prior grant of standing to equity committee.
- Committees may face a more stringent standard when seeking derivative standing to settle litigation over a debtor's objection. *In re Smart World Tech., LLC*, 423 F.3d 166 (2d Cir. 2005).

Divisive Mergers

Overview of Division Statutes

- What are "division statutes" (a/k/a "divisional merger statutes")?
  - Unlike a traditional merger, whereby two or more entities merge to become one entity, **a divisive merger involves one entity dividing into multiple entities**. Further, the dividing entity is not required to terminate in connection with the division and may continue as a surviving entity.
  - These statutes provide a mechanism for a business to divide into:
    - Two or more new entities, with no surviving entity; or
    - A surviving entity and one or more new entities.
  - The dividing entity's assets and liabilities are allocated among the new entities or among the surviving entity and the new entity (or entities).

Overview of Division Statutes (con't)

- Why are Division Statutes used?
  - They help facilitate business objectives.
  - They help promote efficiency in accomplishing internal restructurings by operation of law.
  - They allow companies to deal with contingent liabilities.
    - Generally, an entity that assigns its obligations to another entity remains contingently liable for those obligations. However, Division Statutes provide for the allocation of obligations from one entity to a new entity with no other entity (other than the new entity) have liability for them.

Division Statutes by State

State	Statute	Year Statute Was Initially Enacted	Statute Nickname
Pennsylvania	Pennsylvania Entity Transaction Law § 361 *et seq.*	**1988**	Pennsylvania Polka
Texas	Texas Business Organizations Code § 10.001 *et seq.*	**1989**	Texas Two-Step
Arizona	Arizona Entity Restructuring Act § 29-2601 *et seq.*	**2015**	Arizona Allemande
Delaware	Delaware LLC Act § 18-217 *et seq.*	**2018**	Delaware Disco
Kansas	Kansas Revised LLC Act § 17-7685a *et seq.*	**2019**	Kansas-Kabuki

The Dance Steps – In a Nutshell

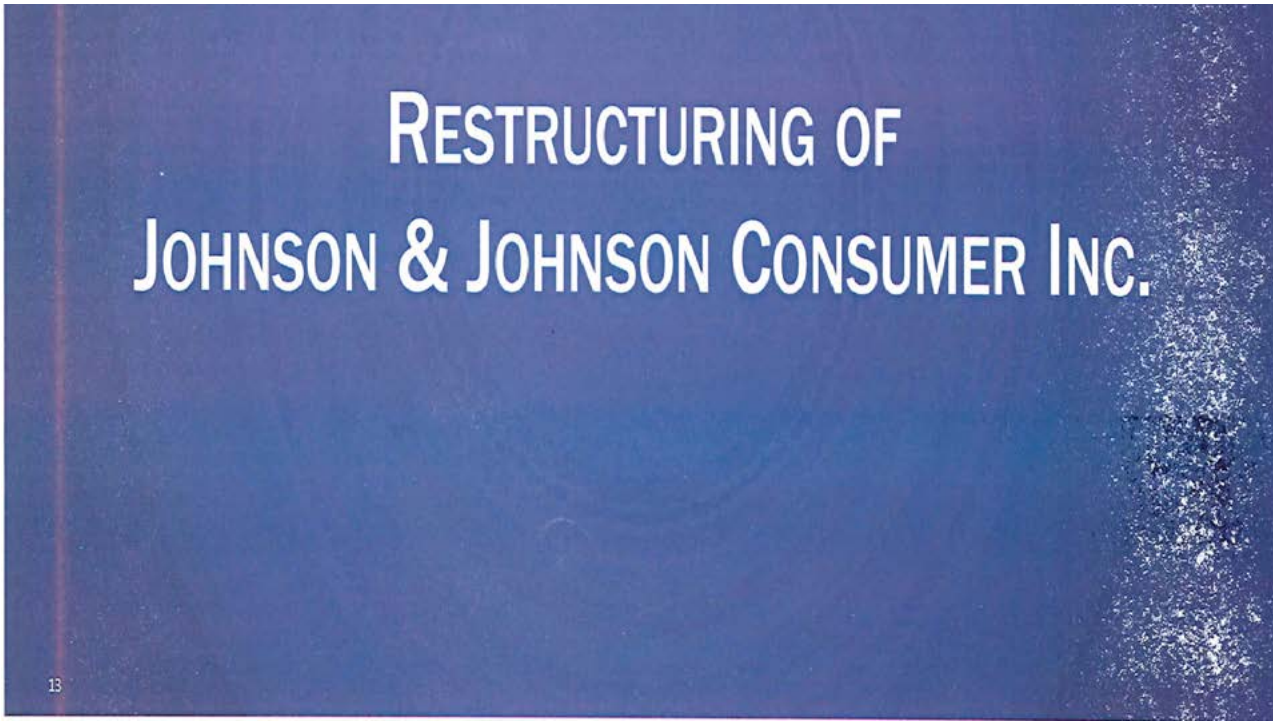
- The Two-Step anticipates the movement of assets and liabilities from one corporate entity to another, via a divisive merger that splits the assets and liabilities of the original entity.
  - After the movement of the assets and liabilities, the assets sit in one entity (*i.e.*, NewCo or GoodCo); the liabilities sit in another entity (often a subsidiary of a larger enterprise) (*i.e.*, DebtorCo or BadCo).
- The companies then convert to whatever type of entity they want to be going forward for corporate governance (or venue) purposes, and the entity with the bulk of the liabilities then files for bankruptcy.
- The Two-Step is central to the Johnson & Johnson ("J&J") bankruptcy of a subsidiary, aiming to separate the talc liabilities from J&J's extensive assets.
  - J&J had followed examples of prior cases including Georgia Pacific (the first to deploy the mechanism in 2017), Trane Technologies, and a U.S. unit of France-based Saint-Gobain – DBMP LLC (CertainTeed, a Texas limited liability company).

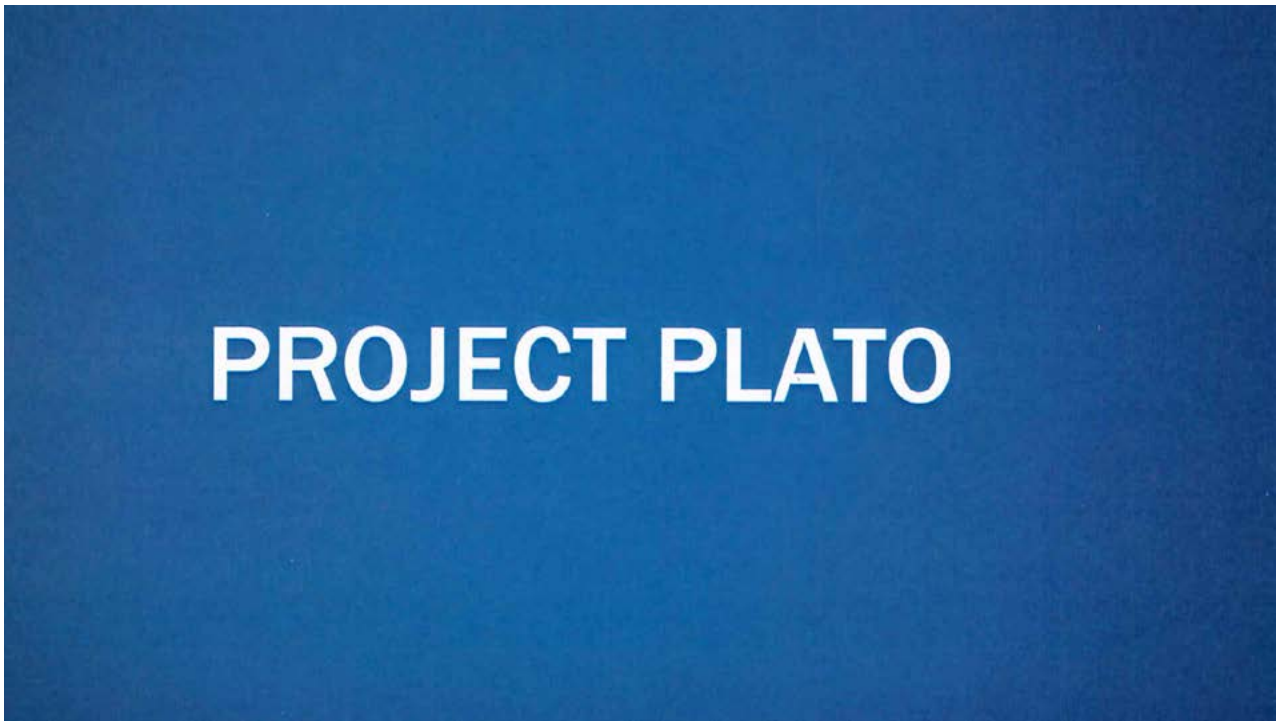
MID-ATLANTIC BANKRUPTCY WORKSHOP

LTL Management, LLC
Case No. 21-30589

Johnson & Johnson

and the "Texas Two-Step"





AMERICAN BANKRUPTCY INSTITUTE

MID-ATLANTIC BANKRUPTCY WORKSHOP

1894	1972	1979	1981	1988	1997	2015
J&J begins selling JOHNSON's® Baby Powder 	Baby Products Division created Johnson's baby	Baby Products Division is transferred to J&J Baby Products Company subsidiary, which assumed all liabilities of Division	J&J Baby Products Company transfers all but diaper assets to Omni Education Corporation, wholly-owned subsidiary, which assumes liabilities associated with transferred assets Omni changes name to Johnson Baby Products Company	Johnson Baby Products Company transfers all Baby Powder assets to J&J Dental Products Company, which assumes all liabilities and is renamed J&J Consumer Products, Inc.	J&J Consumer Products, Inc. renamed J&J Consumer Companies, Inc. Johnson & Johnson CONSUMER PRODUCTS COMPANY	J&J Consumer Companies, Inc. mergers with and into McNeil-PPC, Inc. Resulting entity is renamed **J&J Consumer Inc. ("JJCI")** Johnson & Johnson CONSUMER INC.

Johnson & Johnson

Memorandum of Approval

Debtor Exhibit D-69

PRIVILEGED & CONFIDENTIAL ATTORNEY-CLIENT COMMUNICATIONS ATTORNEY WORK PRODUCT

Approval Request – Memorandum of Approval

Date: October 11, 2021

To: Thibaut Mongon, Paul Rab, Robert J. Decker, II, Michelle Ryan, Louise Weingold, Matthew Orlando, Chris Andrew, Robert Deberardine, David McDonald

Cc: Erik Haas, Andrew Whitt, Valeria Corcoran, Dante McGraw, Alyson Lawrence, Catherine Turk, Chuck Bowe, Duane Van Arsdale, Laure Alvarado, Peter Kertsos, Laura Giacino

Subject: Approval Request for the Restructuring of Johnson & Johnson Consumer Inc.

I. Executive Summary

We are requesting your approval to:

- Proceed with a restructuring of Johnson & Johnson Consumer Inc. ("JJCI") pursuant to a divisional merger (the "Divisional Merger") that ultimately will result in the formation of two successor entities to JJCI: LTL Management LLC, a North Carolina limited liability company ("LTL") and Johnson & Johnson Consumer Inc. ("New JJCI"), a New Jersey corporation, with new and all current and future product liability related claims associated with talc and talc-containing products (the "Claims") allocated to LTL in the Divisional Merger;
- Delegate authority to the LTL Board of Managers (the "LTL Board") to determine whether to proceed with a voluntary petition under chapter 11 of the Bankruptcy Code (the "Bankruptcy");
- Form Royalty Add1 LLC, a North Carolina limited liability company ("RAM"), and authorize RAM to conduct the business of identifying and investing in healthcare related royalty streams as a wholly owned subsidiary of LTL; and
- Enter into the Funding Agreement and Settlement Facility Agreement described in Section 2 below.

Implementation of the steps described in Section 2 below (the "Restructuring") will allow New JJCI to continue to operate Johnson & Johnson's Consumer Health business in the United States without interruption and provide LTL with the opportunity to pursue a process to resolve current and future Claims in an equitable and efficient manner.

LTL 0021701

Page 1 of 11

8. Due Diligence

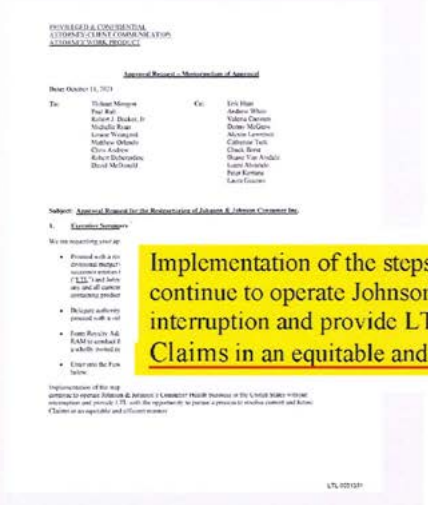
The Restructuring has been reviewed by representatives of local and functional teams listed below.

Function	Representative
Controller	A. Lisman
Corporate Law	C. Andrew & V. Coulson
Corporate Secretary	M. Larkin & L. Giacino
Corporate Tax	D. McGraw
Corporate Treasury	L. Freyne & M. Vertenten
Finance	S. Kowalski & C. Stanzione
Litigation	A. White & K. Manfre
Patent Law	M. McCormack, J. Chiodo & A. Kessel
Trademark Law	J. Feldman & M. Pater
Regulatory (Registration, notified bodies)	G. Murphy & E. Scott
Human Resources	L. Berlin & N. Petito
Information Technology	S. Prud'homme & M. Riewe
Supply Chain	P. Karnik & K. Januzzi
Communications	K. Montagnino & M. Munoz

16

Debtor Ex. D-69

Project Plato Approval



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- Proceed with a re… (divisional merger)… ("LTL") and John… and all current… containing product
- Delegate authority… proceed with a vol…
- Form Royalty Add… RAM to conduct t… a wholly owned su…
- Enter into the Fun… below.

Implementation of the step… continue to operate Johnson & Johnson's Consumer Health business in the United States without… and provide LTL with the opportunity to pursue a process to resolve current and future… Claims in an equitable and efficient manner.

LTL 0021701

Date: October 11, 2021

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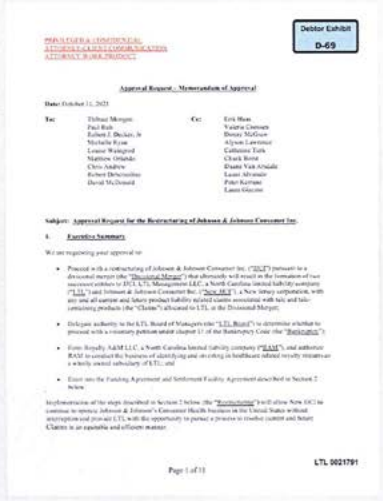
42

Debtor Ex. D-56

Memorandum of Approval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D-69

Approval Request – Memorandum of Approval

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- Delegate authority to the LTL Board of Managers (the "LTL Board") to determine whether to proceed with a voluntary petition under chapter 11 of the Bankruptcy Code (the "Bankruptcy");
- Form Royalty A&M LLC, a North Carolina limited liability company ("RAM"), and authorize RAM to conduct the business of identifying and investing in healthcare related royalty streams as a wholly owned subsidiary of LTL; and
- Enter into the Funding Agreement and Settlement Facility Agreement described in Section 2 below.

LTL 0021791

Page 1 of 11

17

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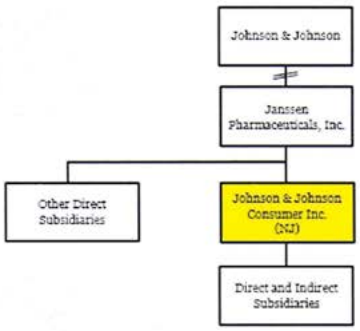
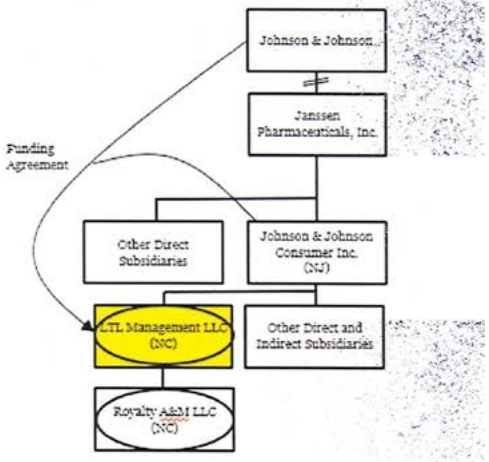
Restructuring of Johnson & Johnson Consumer Inc.

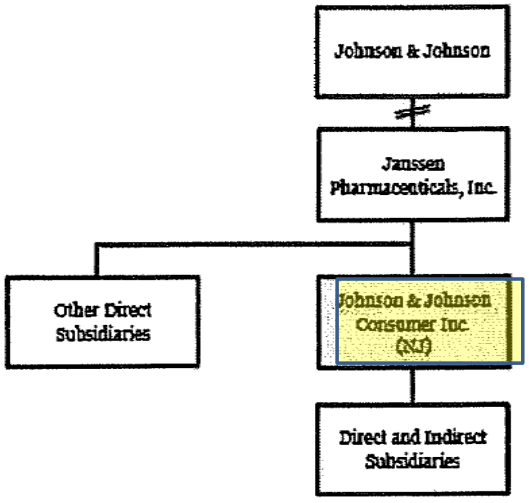
Beginning Structure



Ending Structure



Beginning Structure

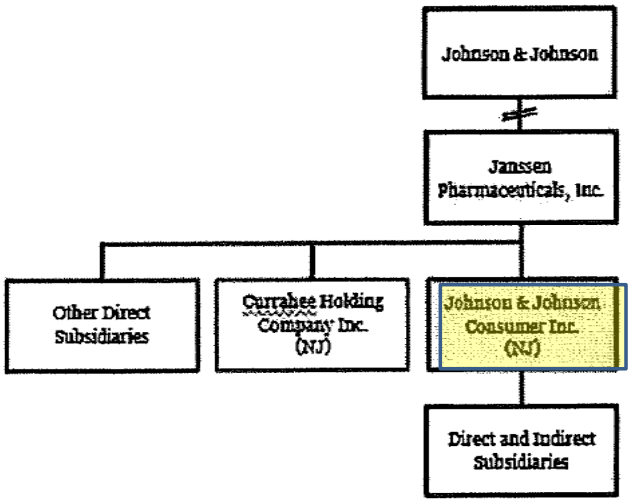


Key:

Talc Liability

Disregarded Entity =

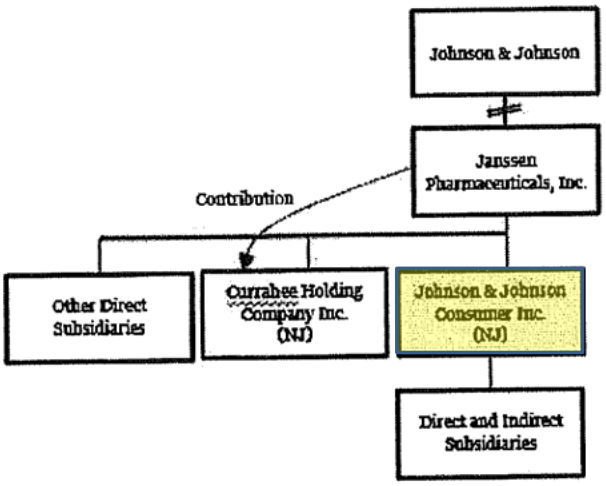
Step 1



Organize New Jersey Corporation as New Direct Subsidiary of Janssen Pharmaceuticals, Inc.

Janssen Pharmaceuticals, Inc. organizes a New Jersey corporation having the name "Currahee Holding Company Inc."; this entity is treated as a C corporation for U.S. federal income tax purposes.

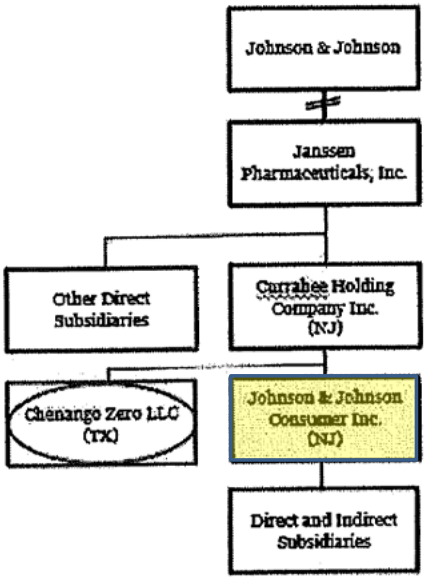
Step 2



Contribute 100% of Ownership of Johnson & Johnson Consumer Inc. to Currahee Holding Company Inc.

Janssen Pharmaceuticals, Inc. contributes 100% of ownership interest in Johnson & Johnson Consumer Inc. ("JJCI") to Currahee Holding Company Inc.

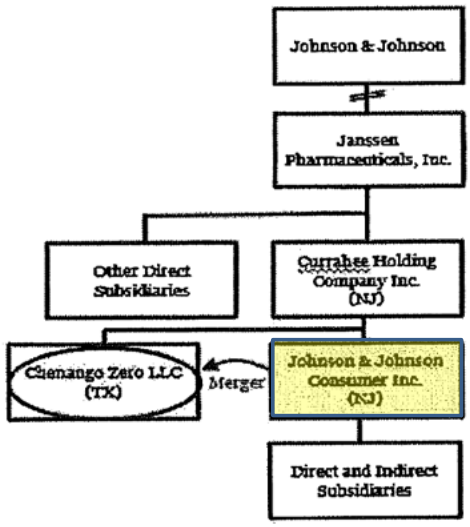
Step 3



Organize Texas Limited Liability Company as New Direct Subsidiary of Currahee Holding Company Inc.

Currahee Holding Company Inc. organizes a new Texas limited liability company having the name "Chenango Zero LLC"; this entity is treated as a disregarded entity for U.S. federal income tax purposes.

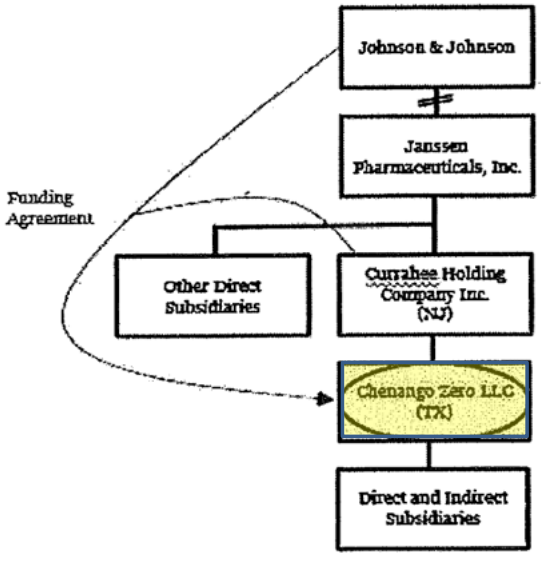
Step 4



Merge JJCI into Chenango Zero LLC

JJCI qualifies Chenango Zero LLC in New Jersey and then merges with and into Chenango Zero LLC by means of a statutory merger, with Chenango Zero LLC as the surviving entity in the merger.

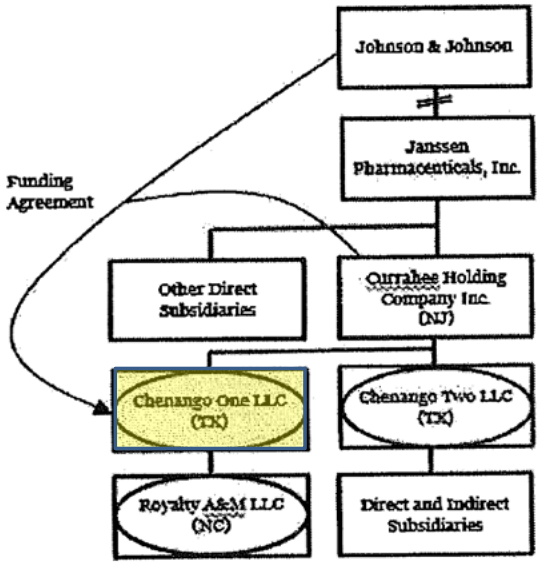
Step 5



Execute Funding Agreement between Johnson & Johnson and Currahee Holding Company Inc., as payors, and Chenango Zero LLC, as payee

Johnson & Johnson and Currahee Holding Company Inc., as payors (on a joint and several basis), and Chenango Zero LLC, as payee, enter into funding agreement ("Funding Agreement").

Step 6



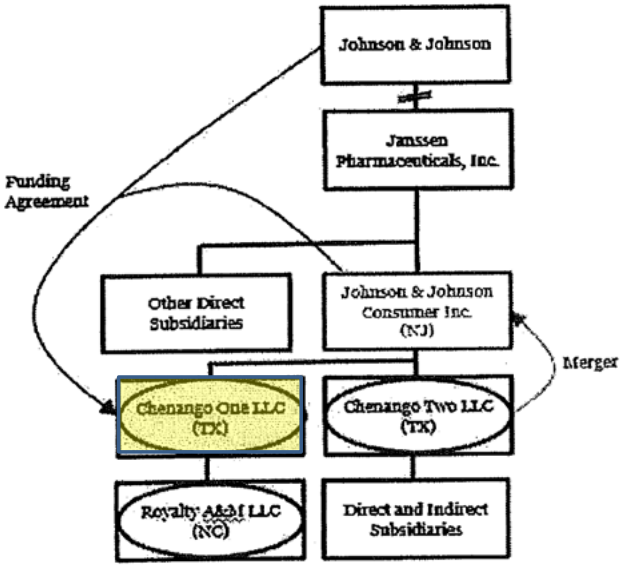
Effect Divisional Merger of Chenango Zero LLC

Chenango Zero LLC effects a statutory divisional merger as a result of which:

1. Chenango Zero LLC ceases to exist;
2. Two new entities are formed, each as a Texas limited liability company that is disregarded for U.S. federal income tax purposes; and
3. the assets and liabilities of Chenango Zero LLC are allocated between the two new entities.

Chenango Zero LLC is withdrawn from New Jersey

Step 7

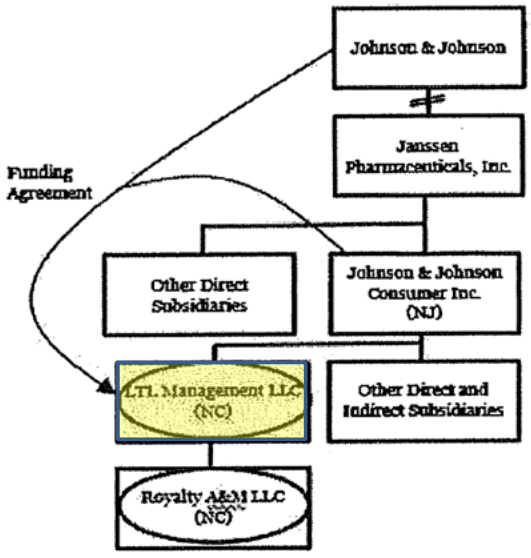


Merge Chenango Two LLC into Currahee Holding Company Inc., which changes its name to "Johnson & Johnson Consumer Inc."

Chenango Two LLC merges with and into Currahee Holding Company Inc. by means of statutory merger, with Currahee Holding Company Inc. as the surviving entity in the merger.

In connection with the merger, Currahee Holding Company Inc. changes its name to "Johnson & Johnson Consumer Inc."

Step 8

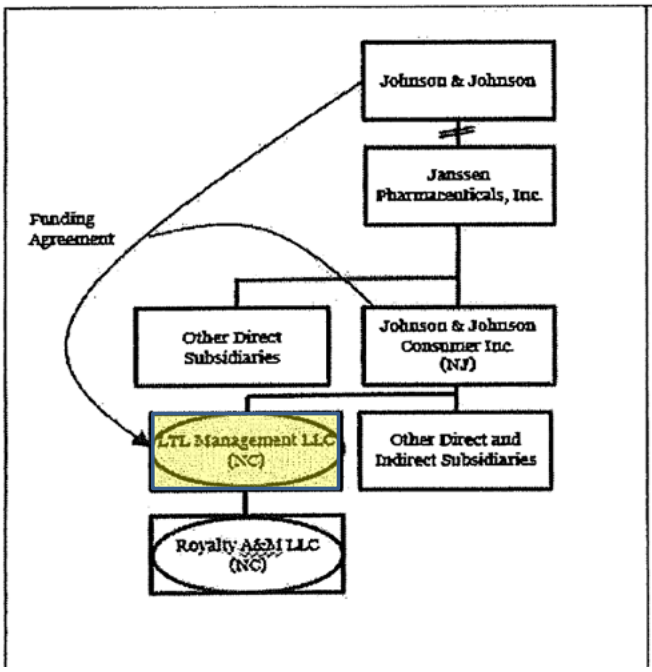


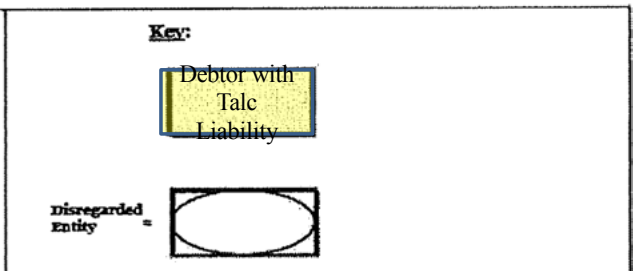
Convert Chenango One LLC from Texas Limited Liability Company into a North Carolina Limited Liability Company, changing its name to "LTL Management LLC"

Chenango One LLC changes from a Texas limited liability company into a North Carolina limited liability company by means of a statutory conversion.

In connection with the conversion, Chenango One LLC changes its name to "LTL Management LLC".

Ending Structure





Pre-Emptive Efforts by the Plaintiff Bar

MISSOURI CIRCUIT COURT TWENTY-SECOND JUDICIAL CIRCUIT
(CITY OF ST. LOUIS)

VICTORIA LYNN GIESE, ANGELA TRENTMANN, AND SUSAN VOGELER,

Plaintiffs,

v.

JOHNSON & JOHNSON

Serve: Steven M. Rosenberg
Registered Agent
One Johnson & Johnson Plaza New Brunswick, NJ 08933

and

JOHNSON & JOHNSON CONSUMER, INC.

Serve: CSC- Lawyers Incorporating Service Company
221 Bolivar Street Jefferson City, MO 65101

Defendants.
PETITION IN EQUITY

Case No. __

PETITION IN EQUITY

1. Plaintiffs Victoria Lynn Giese, Angela Trentmann, and Susan Vogeler ("Plaintiffs") by and through their undersigned counsel, respectfully file this Petition against Defendants Johnson & Johnson ("J&J Global") and Johnson & Johnson Consumer Inc. ("JJCI") ("J&J" when referred to collectively along with other corporate affiliates), seeking a permanent injunction preventing J&J Global and JJCI from utilizing a divisive merger or any other form of transaction to separate their assets from their talc-related liabilities, including the liabilities that may arise from the state-law claims Plaintiffs are pursuing against J&J before the

Pre-Emptive Causes of Action

- Violations of State Uniform Fraudulent Transfer Act by J&J and JJCI as to Present and Future Creditors
- Declaratory Judgment of Successor Liability

Relief Sought:

- Permanent injunction preventing J&J from using divisive merger strategy or comparable corporate transaction
- Judgment avoiding transfers and order prohibiting JJCI from transferring assets made with intent to hinder, delay or defraud/or if made while undercapitalized or insolvent
- Judgment directing return of assets, including dividends
- Attachment of liens to assets transferred by JJCI and imposition of constructive trust
- Declaratory judgment that any entity with assets resulting from divisive merger is liable to plaintiffs under successor liability
- Accounting

NJ Court Won't Stop J&J's 'Texas Two-Step' In Talc Suits

By **Bill Wichert**

Law360 (September 21, 2021, 5:26 PM EDT) -- A New Jersey state judge refused to preemptively block Johnson & Johnson from engaging in a bankruptcy maneuver, the so-called Texas Two-Step, that cancer patients say would unlawfully shield company assets from claims its talcum powder products caused their illness.

In rejecting their application for a temporary restraining order and preliminary injunction against the pharmaceutical giant, Superior Court Judge John C. Porto on Monday said that plaintiffs Brandi Carl and Diana Balderrama want him "to assume the defendants intend to conduct a fraudulent transaction" but that he "cannot make that leap."

"From the court's perspective, and without knowing the terms of an actual transaction and the solvency of the debtor, this court cannot evaluate whether there would ever be a fraudulent or voidable conveyance because there is no conveyance or merger at all to analyze (generic or otherwise)," Judge Porto wrote.

J&J Won't Be Barred From 'Texas Two-Step' In Delaware Court

By Cara Salvatore
Law360 (August 26, 2021, 9:06 PM EDT) -- A Delaware bankruptcy judge refused Thursday to forbid Johnson & Johnson from enacting a rumored plan to move talc liabilities into a separate entity destined for Chapter 11, according to counsel for cancer patients suing J&J.

A Delaware bankruptcy judge refused to forbid Johnson & Johnson from enacting a rumored plan to move talc liabilities into a separate entity destined for Chapter 11, according to a lawyer for women who believe their cancers stem from long-term talc use. (AP Photo/Mel Evans)

U.S. Bankruptcy Court Judge Laurie Selber Silverstein refused a request by ovarian cancer patients for a restraining order that would have blocked J&J's path toward a Texas-centered bankruptcy maneuver often called a "Texas two-step," according to a spokesman for Andy Birchfield of Beasley Allen. Birchfield is a lawyer for the women in their talc liability case, who believe their cancers stem from long-term talc use.

Post-Bankruptcy Challenges:

Fraudulent Transfer Claims

Fraudulent Transfer Challenges

- When assets are transferred from a company that is thereby rendered insolvent, or when the assets are transferred with actual intent to hinder, delay or defraud creditors, the transferred assets can be recovered by the transferring firm as a fraudulent transfer under Bankruptcy Code § 548 or under applicable state law.
- Creditors may seek to unwind the divisional merger as a fraudulent transfer.
  - **Actual Fraudulent Transfer**: transfer made with the actual intent to hinder, delay, or defraud creditors. *See* § 548(a)(1)(A).
  - **Constructive Fraudulent Transfer**: The debtor . . . (a) received less than reasonably equivalent value in exchange for such transfer or obligation, or (b) the debtor was insolvent at the time of the transfer or became insolvent as a result of the transfer. *See* § 548(a)(1)(B)(i)-(ii).
- For example, a fraudulent transfer complaint was filed in the DBMP case: *Official Committee of Asbestos Personal Injury Claimants v. CertainTeed LLC et al.*, Adv. Pro. No. 22-03000 (Whitley, J.) ("**In re DBMP**").

The Fraudulent Transfer Conundrum

- The Texas divisive merger statute, however, creates a conundrum because it says movements of assets pursuant to a divisive merger **are not transfers**. If there's no transfer, there's no fraudulent transfer liability, as there must first be a transfer for there to be liability.

- The Texas statute itself states that there is no transfer under Texas law:
  - "When a merger takes effect . . . all rights, title and interests to all . . . property owned by each . . . party to the merger is allocated . . . as provided in the plan of merger ***without . . . any transfer*** or assignment having occurred…" - Tex. Bus. Orgs. Code § 10.008(a)(2) (emphasis added).

***Official Committee of Asbestos Personal Injury Claimants v. CertainTeed LLC et al.*, Adv. Pro. No. 22-03000 ("In re DBMP").**

- This argument has not been explicitly raised in the *LTL bankruptcy*, but it was made in *In re: DBMP*.
  - "Notably, under TBOC, a divisive merger occurs 'without . . . any transfer or assignment having occurred.' Tex. Bus. Orgs. Code § 10.008(a)(2)(C). As such, Old CT's creation allocation of certain Old CT assets and liabilities between New CT and DBMP is not a transfer under the TBOC." – Mot. to Dismiss [ECF 38], at 16, n.61.
- The Bankruptcy Court, in its July 7 oral ruling:
  - Agreed with the key plain meaning premises of the Texas two-step argument but ultimately rejected it as facilitating "wholesale fraud."
  - Explained that going down the plain meaning route would lead to absurd results, leaving plaintiffs with "no recourse whatsoever," and that such a reading would contradict another provision of the Texas statute, which states that a divisive merger is not meant to "abridge any . . . rights of any creditor under existing law," Tex. Bus. Orgs. Code § 10.901.
  - Noted that such a plain language reading of the Texas statute would run contrary to longstanding general principles of Anglo-American fraudulent transfer law.

The Texas statute contradiction: "It's not a transfer" vs. "it's not in derogation of any other right."

- The Bankruptcy Code also provides an argument that the Texas-Two Step is a transfer:
  - Section 548 states that "The trustee may avoid any *transfer* . . . of an interest of the debtor in property . . . " (emphasis added).
  - Section 101(54) defines what a "transfer" is: "The term 'transfer' means . . . each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with (i) property; or (ii) an interest in property."
- One could argue that a transfer has occurred for each "mode . . . of disposing of . . . Property…" And a divisive merger under Texas law is a "mode . . . of disposing of . . . property. . . ."
- As a result, for bankruptcy purposes a Texas Two-Step could be a transfer. Property has been disposed of, and so, for purposes of the Bankruptcy Code, there is a transfer.
- Thus, the first statutory predicate to considering whether there has been a fraudulent transfer has been satisfied (Slide 4 – whether there's been a transfer of property), and the court could then go on to the other fraudulent transfer issues.

Liability Management Transactions

Liability Management Transactions

- Generally speaking, these are transactions that take advantage of technical construction of loan documents that some would argue was not what was intended at the time of the financing
- **Drop-down financings**

Assets (often intellectual property) are transferred outside of an existing collateral package, using unrestricted subsidiaries, and then those assets are used to secure structurally senior financing

- **Uptiering transactions**

Priming new money or rolled up debt is offered to preferential creditors to enhance the priority of their claims on an existing collateralized loan

Liability Management Transactions

- These are the result of our current covenant lite loan environment
- Creditor on Creditor violence
- Majority and sponsor versus a disenfranchised minority
- Litigation often brought before a bankruptcy filing, but sometimes issues are addressed in the bankruptcy as well- TPC is a recent example

Liability Management Transactions

- TPC Group filed Chapter 11 in Delaware in June 2022
- Before filing bankruptcy, the Debtor and majority (but not all) of holders of 1st lien syndicated loan agree to enter into a new loan that is supported by a superior lien on the same collateral that secured the original 1st lien loan
- In TPC, the Debtor left the original loan outstanding, but it was now junior to the new loan.
- The Debtor sought to roll up the new 1st lien loan into a DIP. If the new 1st lien loan was truly superior to the old 1st lien loan, then the roll up is relatively uncontroversial- if the value of the collateral would be going to pay the new first lien creditors first anyway, then granting them an administrative expense status is not really giving them something they aren't already entitled to.
- The minority lenders who found themselves suddenly in essentially a second lien position brought an adversary proceeding seeking a determination that the new first lien was truly in a superior position, and thus the roll up in the DIP should not be consummated either because the DIP lender would be receiving significant value that would otherwise be unsecured
- Judge Goldblatt agreed to an expedited schedule to have this issue argued on summary judgment motion papers before the final DIP hearing.
- The Indenture allowed many actions to be taken by either a majority or super majority of the bondholders. However, the Indenture also provided that the Debtor could not make any change to the provisions of the Intercreditor Agreement or the Indenture dealing with the application of proceeds of Collateral that would adversely affect all Holders.
- The minority bondholders argued that this provision prohibited the Debtor and majority from entering into the new 1st lien loan.
- Judge Goldblatt disagreed, and noted that the fact that there was not an anti-subordination clause in the indenture was telling that this was in fact something that was allowed under the terms of the Indenture.

Actions Against Directors and Officers

- Directors and Officers have fiduciary duties of care, loyalty and good faith
- Business judgment rule is a rebuttable presumption: any evidence of bad faith, self interest or lack of informed decision making and the Director will be subject to the entire fairness standard
- What transactions get scrutinized the most in bankruptcy? Liability management transactions, dividend recaps, redemptions or stock purchases as well as transactions that result in a change of control

Actions Against Directors and Officers

- In re Wonderwork, 611 B.R. 169 (SDNY 2020)
- Friedman v. Wellspring Capital Mgmt., LLC, 2021 WL 4823513

Questions?

The End

Faculty

Kristin K. Going is a partner in McDermott Will & Emery's Business Restructuring practice in New York and represents clients in bankruptcy and insolvency proceedings. She concentrates her practice in commercial bankruptcy and insolvency matters, creditors' rights, out-of-court workouts and restructurings and financial services litigation. Ms. Going's experience encompasses all facets of bankruptcy and insolvency, including liquidating trusts, chapter 11 plan restructuring and related litigation, § 363 sales, valuation disputes, lien-perfection disputes, single-asset real estate, debtor-in-possession financing, municipal bond finance deals, adversary actions and bankruptcy appeals. She also teaches a course on chapter 11 restructuring at St. John's University School of Law. Ms. Going received her LL.M. in Bankruptcy from St. John's University School of Law.

Hon. Michael B. Kaplan is Chief U.S. Bankruptcy Judge for the District of New Jersey in Trenton, initially appointed on Oct. 3, 2006, and named Chief Judge on May 1, 2020. Prior to taking the bench, Judge Kaplan served as a standing chapter 13 bankruptcy trustee, as well as a member of the chapter 7 panel of bankruptcy trustees, where he received case appointments as both a chapter 11 and chapter 12 trustee. His private practice included the representation of institutional lenders consumer debtors (under both chapters 7 and 13), business debtors and individuals undergoing reorganization pursuant to chapter 11. Judge Kaplan is licensed to practice law in New Jersey, New York and Connecticut, and is admitted to practice before the U.S. Supreme Court, Third Circuit Court of Appeals, U.S. Court of International Trade and various federal district courts. Over the past 30 years, he has spoken to numerous bar associations and business organizations, and authored several articles relating to bankruptcy issues. Judge Kaplan is a co-author of West's *Consumer Bankruptcy Manual* and *Consumer Bankruptcy Handbook*. Additionally, he serves on the editorial board and as business manager for the *American Bankruptcy Law Journal* and teaches as an adjunct professor at Rutgers University School of Law. Judge Kaplan has been elected as a Fellow of the American College of Bankruptcy, and he has been appointed by the director of the Administrative Office of the U.S. Courts (AOUSC) to a term as the Third Circuit representative to the Bankruptcy Judges Advisory Group, in addition to appointments as the bankruptcy judge representative for the Risk and Finance Management Advisory Council, Human Resources Advisory Council and Budget & Finance Advisory Council to the AOUSC. As a member of the National Conference of Bankruptcy Judges, he serves as treasurer and executive board member. Prior to taking the bench, Judge Kaplan served as mayor and councilman for the Borough of Norwood, N.J., and as a member of the Norwood Planning Board. He received his A.B. from Georgetown University in 1984 and his J.D. from Fordham University School of Law in 1987.

Jeffrey N. Rothleder is partner in Squire Patton Boggs (US) LLP's Restructuring and Insolvency practice group in the firm's Washington, D.C., office, where his practice focuses on financial restructuring, corporate trust matters and workout proceedings on behalf of financially distressed companies or their creditors, including the representation of debtors, indenture trustees, creditors and creditors' committees, investors and purchasers in in-court and out-of-court restructurings. Mr. Rothleder represents a wide variety of clients in the enforcement of the entire spectrum of creditors' rights involving secured, unsecured, public or private, and taxable and tax-exempt debt through his work with indenture trustees, lenders, individual creditors and official committees in chapter 11

cases. He also has experience representing debtors, including the restructuring of large companies through the chapter 11 process or conducting the orderly liquidating and comprehensive asset sales for a diverse group of companies. Mr. Rothleder received his B.A. from the University of Michigan in 1999 and his J.D. from the University of Maryland School of Law in 2002 with honors, where he was a member of the Order of the Coif.

Jackson D. Toof is a partner with ArentFox Schiff LLP's Complex Litigation and Bankruptcy and Financial Restructuring Group in the firm's Washington, D.C., office, where he focuses on all aspects of bankruptcy and financial services litigation. He has represented both plaintiffs and defendants in a wide range of commercial matters. Rated AV-Preeminent by Martindale-Hubbell, he has been involved in all aspects of bankruptcy and financial services litigation, including pursuing and defending actions on behalf of various creditor constituencies, complex financial restructurings and valuation disputes, and he has handled all aspects of litigation-enforcing indentures and the rights and remedies of indenture trustees. He also has been involved in ratemaking determinations for digital music licenses before the Copyright Royalty Board, and he has extensive experience defending and pursuing actions in numerous areas, including a variety of business tort, contract and real estate actions, shareholder litigation, noncompete and nonsolicitation litigation, probate litigation, False Claims Act/*qui tam* and health care matters, as well as criminal and white-collar criminal defense. Mr. Toof has first- and second-chaired jury, bench and administrative trials in a variety of civil and criminal matters, and his litigation practice involves all phases of litigation from strategic business counseling and problem-solving through trial and appellate review. He serves on the firm's Professional Conduct Committee and co-chairs the firm's Litigation Support Committee, and was the chair of the firm's Associates Committee from 2009–12. Mr. Toof began his career in 2003 as a litigator while serving on active duty with the U.S. Navy's Judge Advocate General's (JAG) Corps. He continued his service as a Lieutenant Commander in the U.S. Navy reserve until 2012. Mr. Toof has served as an adjunct professor at American University Washington College of Law teaching criminal procedure. He is a member of ABI and the Virginia, Fairfax County, Northern Virginia Bankruptcy, District of Columbia and American Bar Associations. Mr. Toof received his B.A. *summa cum laude* and Phi Beta Kappa in 1999 from the University of New Hampshire and his J.D. in 2002 from American University's Washington College of Law, and he graduated from the Naval Justice School in 2003.

Grayson T. Walter is a member of Bond, Schoeneck & King PLLC in Syracuse, N.Y., where he protects and advances the interests of companies and their stakeholders in a broad range of corporate and transactional matters, with a special focus on the debtor/creditor relationship and the turnaround and restructuring of businesses and organizations experiencing operational turmoil, financial distress or insolvency. He regularly provides his clients with legal counsel and strategic advice in connection with in-court and out-of-court reorganizations, corporate governance and structure, debt- and equity-financing and recapitalization, mergers, acquisitions, divestitures, buyouts and other change-of-control transactions, as well as general commercial and contractual matters. Mr. Walter has represented debtors, equity sponsors, institutional lenders, senior secured, subordinated and unsecured creditors, official committees, franchisees, licensees and bond insurers in a wide variety of bankruptcy proceedings (including bankruptcy-related litigation), receiverships and workouts throughout the U.S., including negotiating debtor-in-possession (DIP) financing on behalf of debtors and lenders; negotiating and confirming chapter 11 plans of reorganization (including prearranged plans); representing buyers and sellers of distressed business assets in transactions under § 363 and Article 9 of the UCC;

prosecuting and defending actions to recover preferential or fraudulent transfers, including successfully defending multiple colleges, universities and other educational institutions against tuition clawback attempts; achieving recognition of critical-vendor status and pre-confirmation payment of pre-petition trade debt; and achieving court approval of post-petition management incentive bonus payments. He also has experience representing public and private companies engaged in a wide variety of industries and activities, including private investment, finance, manufacturing, technology, health care, transportation and logistics, energy, construction and retail. Mr. Walter has worked extensively with many higher-education institutions and other nonprofit organizations. He is secretary and trustee of the Central New York Bankruptcy Bar Association and sits on the board of directors of the Onondaga County Assigned Counsel Program. Mr. Walter received his undergraduate degree from Hamilton College and his J.D. from Vanderbilt University Law School.