DON'T MESS WITH TEXAS(?): ANALYZING THE TEXAS TWO-STEP BANKRUPTCIES

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INTRODUCTION

Asbestos litigation involves more parties and higher costs than any other type of personal injury litigation.[1] Consequently, it has driven numerous businesses into bankruptcy.[2] Bankruptcy laws are fundamentally a matter of public policy. The Supreme Court has recognized two policies underlying Chapter 11 Bankruptcy: "preserving going concerns and maximizing [the] property available to satisfy creditors."[3] To facilitate successful reorganizations, the Bankruptcy Code provides courts with significant powers, like the

1. Michelle J. White, *Asbestos and the Future of Mass Torts*, 18 J. ECON. PERSPS. 183, 183 (2004).

2. *Id.*

3. Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999).

automatic stay,[4] and broader jurisdiction than a typical federal court.[5] However, reorganizing under Chapter 11 is not without significant costs. Businesses that file bankruptcy must subject themselves to additional oversight by the court and their creditors and suffer the market stigma that accompanies a bankruptcy filing.[6]

In recent years, businesses facing mass tort liability from asbestos claims have formulated a strategy using Texas law that seemingly allows them to reap all the benefits of bankruptcy without subjecting their entire enterprise to its burdens. The strategy involves a business temporarily incorporating in Texas and undergoing a divisional merger under Texas law.[7] Through the merger, the business assigns its valuable assets to one successor entity and its mass tort liability to another, which then files Chapter 11 bankruptcy.[8] Due to its use of Texas law, this strategy has been dubbed the "Texas Two-Step."[9] The goal of the Texas Two-Step is for the business to effectuate a global settlement of its current and future asbestos liability.

While the insolvent successor undergoes bankruptcy proceedings, the solvent successor retains its valuable assets, maintains control over its affairs, and enjoys the protection of the automatic stay without filing bankruptcy itself. Moreover, if the Texas Two-Step works according to plan, both successors may be permanently shielded from all outstanding asbestos liability. This is accomplished through the debtor's Chapter 11 plan, creating a settlement trust under section 524(g) of the Bankruptcy Code. The trust consists of funds contributed by the debtor and its affiliates and is accompanied by a channeling injunction that directs all asbestos claims toward the trust, effectively releasing the debtor and its affiliates from liability.[10] Notably, in these cases, the debtors have insisted that they intend to provide the claimants with full payment

4. 11 U.S.C. § 362.

5. 28 U.S.C. § 1334(b) ("[T]he district courts shall have original but not exclusive jurisdiction of all civil proceedings *arising under* title 11, or *arising in* or *related to* cases under title 11." (emphasis added)).

6. *See, e.g.*, Medha Singh, *WeWork Shares Sink to Record Low on Reports Bankruptcy Filing Imminent*, REUTERS (Nov. 1, 2023), https://perma.cc/RDJ3-QWZY.

7. TEX. BUS. ORGS. CODE ANN. § 1.002(55)(A) (2022).

8. *See infra* Part II.

9. *In re* Bestwall LLC, 658 B.R. 348, 352 (Bankr. W.D.N.C. 2024).

10. *See In re* LTL Mgmt., LLC, 64 F.4th 84, 97 (3d Cir. 2023) ("LTL's first-day filings described the bankruptcy as an effort to 'equitably and permanently resolve all current and future talc-related claims against it through the consummation of a plan of reorganization that includes the establishment of a [funding] trust.'").

but prefer the efficiency of resolving the claims through bankruptcy trusts.[11]

Recently, the Texas Two-Step has been under fire from claimants,[12] courts,[13] legal scholars,[14] and members of the United States Senate.[15] Some courts have even dismissed cases employing the Texas Two-Step or similar strategies for being filed in bad faith.[16] But in the Fourth Circuit, where courts are virtually unable to dismiss Chapter 11 filings for lack of good faith under longstanding circuit precedent,[17] three Texas Two-Step bankruptcies—*Bestwall*,[18] *Aldrich Pump*,[19] and *DBMP*[20]—have been proceeding in the Western District of North Carolina Bankruptcy Court for years. Furthermore,

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11. *See, e.g.*, The Debtor's Objection to Motion of the Official Committee of Asbestos Claimants to Dismiss the Chapter 11 Case, or Alternatively, Transfer Venue at 2, *In re* Bestwall LLC, 605 B.R. 43 (Bankr. W.D.N.C. 2019) (No. 17-31795); DBMP LLC v. Those Parties Listed on Appendix A to Complaint (*In re* DBMP LLC), No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350, at *43 (Bankr. W.D.N.C. Aug. 11, 2021); *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *2 (Bankr. W.D.N.C. Dec. 28, 2023); *In re* LTL Mgmt., LLC, 637 B.R. 396, 404 (Bankr. D.N.J. 2022).

12. *See, e.g.*, *Evading Accountability: Corporate Manipulation of Chapter 11 Bankruptcy: Hearing Before the S. Comm. on the Judiciary*, 118th Cong. (Sept. 19, 2023) (testimony of Lori Knapp).

13. *In re* Bestwall LLC, 71 F.4th 168, 194 (4th Cir. 2023) (King, J., dissenting) ("In sum, I would squarely reject Georgia-Pacific's use of its 2017 restructuring—little more than a corporate shell game—to artificially invoke the jurisdiction of the bankruptcy court and obtain shelter from its substantial asbestos liabilities without ever having to file for bankruptcy.").

14. *See, e.g.*, Samir D. Parikh, *Mass Exploitation*, 170 U. PA. L. REV. ONLINE 53 (2022).

15. *Evading Accountability: Corporate Manipulation of Chapter 11 Bankruptcy*: *Hearing Before the S. Comm. on the Judiciary*, *supra* note 12 (statement of Sen. Josh Hawley).

16. *See In re* LTL Mgmt., LLC, 64 F.4th 84, 93 (3d Cir. 2023) (dismissing a Texas Two-Step case for lack of good faith); *In re* Aearo Techs. LLC, No. 22-02890, 2023 WL 3938436, at *1 (Bankr. S.D. Ind. June 9, 2023) (in a non-asbestos case with many similarities to a Texas Two-Step case, Aearo Technologies, a pre-existing subsidiary of 3M, had its bankruptcy dismissed for lack of good faith due to it not facing legitimate insolvency).

17. *See* Carolin Corp. v. Miller, 886 F.2d 693, 700–01 (4th Cir. 1989) (requiring "both objective futility and subjective bad faith be shown in order to warrant dismissals for want of good faith in filing").

18. *In re* Bestwall LLC, 605 B.R. 43 (Bankr. W.D.N.C. 2019) (the first Texas Two-Step case).

19. *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506 (Bankr. W.D.N.C. Dec. 28, 2023).

20. DBMP LLC v. Those Parties Listed on Appendix A to Complaint (*In re* DBMP LLC), No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350 (Bankr. W.D.N.C. Aug. 11, 2021).

challenges to these bankruptcies on jurisdictional and constitutional grounds have proved unsuccessful so far.[21]

This Comment seeks to add further nuance to the discussion of the Texas Two-Step by arguing in favor of the cases being resolved in bankruptcy through the establishment of a settlement trust. While this Comment recognizes that there are likely legitimate grounds for dismissal in the *Aldrich Pump* and *DBMP* cases and that constitutional limitations will likely prevent the debtors from achieving a one-time global resolution, it posits that resolving these cases in bankruptcy could benefit the claimants, the debtors, and the judicial system.

This Comment proceeds in five parts. Part I explains why corporations wish to resolve their asbestos liability through Chapter 11 bankruptcy. Part II provides an in-depth examination of the mechanics of the Texas Two-Step. Part III examines some of the Texas Two-Step bankruptcies and analyzes the challenges addressed by courts that have proved largely unsuccessful thus far. Part IV analyzes current and potential challenges to the Texas Two-Step. Part V argues that businesses using the Texas Two-Step and attempting to resolve asbestos claims in bankruptcy do not harm claimants. It further contends that a limited resolution in bankruptcy, which establishes a settlement trust that allows claimants to opt out, could, in theory, work to serve the claimants' interests, protect their constitutional rights, and effectuate an equitable and efficient settlement. Finally, it concludes that while, in theory, a trust plan that comports with constitutional limitations could be beneficial, it is practically unlikely.

I. WHY RESOLVE MASS TORTS IN BANKRUPTCY?

Many scholars argue that bankruptcy is a highly attractive forum for the resolution of mass torts.[22] Bankruptcy courts are vested with broad jurisdiction and enabled to resolve all claims against a debtor, state or federal, in a single forum.[23] Consolidating and resolving every

21. *In re* Bestwall LLC, 71 F.4th 168 (4th Cir. 2023); *Aldrich Pump*, 2023 WL 9016506. Notably, another constitutional challenge in the *Bestwall* case is currently pending before the Fourth Circuit Court of Appeals. *See In re* Bestwall LLC, 658 B.R. 348 (Bankr. W.D.N.C. 2024), *appeal docketed sub nom.* Bestwall LLC v. Off. Comm. of Asbestos Claimants (*In re* Bestwall LLC), No. 24-1493 (4th Cir. May 31, 2024). However, I believe that dismissal on constitutional grounds is unlikely and that the Supreme Court would not uphold such a decision.

22. *See* Parikh, *supra* note 14, at 59–64; Anthony J. Casey & Joshua C. Macey, *In Defense of Chapter 11 for Mass Torts*, 90 U. CHI. L. REV. 973 (2023); Douglas G. Smith, *Resolution of Mass Tort Claims in the Bankruptcy System*, 41 U.C. DAVIS L. REV. 1613 (2008).

23. *Evading Accountability: Corporate Manipulation of Chapter 11 Bankruptcy: Hearing Before the S. Comm. on the Judiciary*, 118th Cong. (Sept.

action against the debtor in a single tribunal promotes economic efficiency and reduces administrative expenses arising from research and discovery in duplicative litigation.[24] Moreover, the protection afforded by the automatic stay[25] temporarily enjoins creditors from pursuing their claims against the debtor and frequently extends to non-debtor affiliates, allowing the parties to direct their focus on reaching a settlement.[26] Furthermore, scholars argue that mass tort cases create a collective action problem, encouraging claimants to race to the courthouse, ultimately risking the going concern of businesses.[27] The automatic stay prevents this race and handles all the claims in one forum, with the goal of reaching a comprehensive settlement for all claimants.[28]

Chapter 11 of the Bankruptcy Code (the "Code") gives the parties significant latitude in formulating a plan. The Code has relatively few requirements aside from the debtor designating classes of claims and interests for treatment under the reorganization, providing equal treatment for each claim or interest of a particular class, and providing adequate means for the plan's implementation.[29] Most of the plan results from negotiations between creditors and the debtor. Once a plan is presented, the debtor must provide creditors with disclosure statements,[30] and once creditors accept a plan, it still must be approved by the bankruptcy court.[31] To confirm the plan, the court must find, among other things, that (1) the plan is feasible; (2) proposed in good faith; and (3) the plan and the proponent of the plan are in compliance with the Code.[32]

Scholars credit the movement to bankruptcy to discontent with the tort system and the difficulty of obtaining class certification.[33] The Supreme Court's decisions in *Amchem Products, Inc. v. Windsor*[34] and *Ortiz v. Fibreboard Corp*.[35] closed the door on asbestos cases and most other mass torts from being aggregated in class actions, so parties are left litigating in state court and multi-district litigation proceedings. Asbestos litigation has proved particularly challenging due to the

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19, 2023) [hereinafter Parikh Statement] (written statement of Prof. Samir D. Parikh), https://perma.cc/5QYQ-UK24.

24. Casey & Macey, *supra* note 22, at 1000.

25. 11 U.S.C. § 362(a).

26. Parikh Statement, *supra* note 23, at 2.

27. Casey & Macey, *supra* note 22, at 995.

28. *Id.* at 1000–01.

29. 11 U.S.C. § 1123(a).

30. *Id.* § 1125(c).

31. *Id.* § 1129(a).

32. *Chapter 11 – Bankruptcy Basics*, U.S. CTS. (2024), https://perma.cc/QPY7-TA2L.

33. *See* Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. 447, 469–79 (2022).

34. 521 U.S. 591 (1997).

35. 527 U.S. 815 (1999).

sheer quantity of claims,[36] the complex evidentiary issues involved,[37] and the challenges of combatting fraud and abuse.[38] In response to asbestos litigation driving numerous businesses into bankruptcy, Congress has codified a mechanism for businesses to resolve their asbestos liability in bankruptcy through a section 524(g) trust.

As part of a Chapter 11 plan, a debtor may be able to establish a section 524(g) settlement trust accompanied by a channeling injunction that directs all present and future claims arising out of its asbestos liability to the trust.[39] The injunction effectively releases the debtor and all other protected parties from their asbestos liability. The trust works as an efficient settlement vehicle and provides payment to claimants who meet certain criteria set forth in the plan. Congress specifically codified this approach following *In re Johns-Manville Corp*.[40] and added several provisions to protect the claimants' interests, like requiring a 75 percent majority of the claimants to vote in favor of the plan for it to be accepted.[41] The debtors in these cases believe that trusts can be a more efficient means to allow deserving claimants to recover while reducing the expenses associated with filtering out disreputable claims.[42]

To calculate the amount the debtor must contribute to the trust, the Code allows the court to identify and value the aggregate of all present and future claims against the debtor.[43] This is typically done using data from past settlements of similar claims.[44] The debtor can then use this figure as a basis for its settlement, which is proposed as part of its plan of reorganization.[45] A committee of tort claimants appointed by the U.S. Trustee (or Bankruptcy Administrator in Alabama and North Carolina) is empowered to negotiate on behalf of all claimants and wields significant leverage in negotiations, as the court may opt to dismiss the case or convert it to a liquidation after a set amount of time.[46] This encourages the debtor to put its best foot

36. *Id.* at 821.

37. Smith, *supra* note 22, at 1626–27.

38. *See* Keith N. Hylton, *Asbestos and Mass Torts with Fraudulent Victims*, 37 SW. U. L. REV. 575, 586–88 (2008); *In re* Garlock Sealing Techs., LLC., 504 B.R. 71, 94 (Bankr. W.D.N.C. 2014) ("[T]he settlement history data does not accurately reflect fair settlements because exposure evidence was withheld. While that practice was not uniform, it was widespread and significant enough to infect fatally the settlement process and historic data.").

39. 11 U.S.C. § 524(g).

40. 68 B.R. 618 (Bankr. S.D.N.Y. 1986).

41. 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb).

42. *See, e.g.*, Informational Brief of Bestwall LLC at 8, *In re* Bestwall LLC, 605 B.R. 43 (Bankr. W.D.N.C. 2019) (No. 17-31795).

43. 11 U.S.C. § 502(c).

44. *See, e.g.*, Bestwall LLC v. Armstrong World Indus., Inc. (*In re* Bestwall LLC), 47 F.4th 233, 239 (3d Cir. 2022).

45. Parikh Statement, *supra* note 23, at 7.

46. *Id.*

forward early on.[47] Also, by statute in asbestos trust cases,[48] a future claims representative is appointed to negotiate on behalf of the future victims.[49]

It is worth noting that the Supreme Court recently decided that the Code does *not* authorize nonconsensual non-debtor releases *outside of the asbestos context* in *Harrington v. Purdue Pharma L.P.*[50] However, even absent nonconsensual releases, resolving the Texas Two-Step cases and other mass tort cases in bankruptcy can still be extremely beneficial.[51]

II. THE TEXAS TWO-STEP EXPLAINED

There are numerous benefits to establishing a bankruptcy trust: reduced costs, balanced recoveries, and resolution of claims at a faster pace than through traditional litigation.[52] However, establishing a bankruptcy trust requires a business to file bankruptcy and endure its attendant burdens. In bankruptcy, businesses lose much of their autonomy by subjecting themselves to the oversight of the bankruptcy court, creditors, and the U.S. Trustee. Furthermore, publicly traded companies also face the market effects that come with bankruptcy due to its typical effect of leaving unsecured creditors and shareholders holding the bag. To get around this issue, innovative bankruptcy lawyers engineered the Texas Two-Step.

The Texas Two-Step theoretically allows a solvent business to separate into two entities, allocate its assets to one entity and its liabilities to the other, and send the liability-ridden entity into bankruptcy to resolve the liabilities through the confirmation of a Chapter 11 plan. The first step involves the original business ("OldCo"), which is facing mass tort liability, incorporating in Texas to access the Texas Business Organizations Code ("TBOC").[53] Somewhat unique to the TBOC is its definition of a merger. The TBOC includes in its definition of a merger "the division of a domestic entity into two 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."[54] Employing the Texas divisional merger, OldCo allocates the lion's share of its valuable

47. *See id.*
48. 11 U.S.C. § 524(g)(4)(B)(i).
49. *Id.*
50. Harrington v. Purdue Pharma L.P., 144 S. Ct. 2071, 2085, 2087 (2024).
51. *See infra* Section V.B.
52. *In re* LTL Mgmt., LLC, 637 B.R. 396, 407, 415 (Bankr. D.N.J. 2022).
53. *See* Aldrich Pump LLC v. Those Parties to Actions Listed on Appendix A to Complaint (*In re* Aldrich Pump LLC), No. 20-30608, Adv. No. 20-03041, 2021 WL 3729335, at *9–10 (Bankr. W.D.N.C. Aug. 23, 2021).
54. TEX. BUS. ORGS. CODE ANN. § 1.002(55)(A) (2022).

assets to one successor ("GoodCo") and its tort liability to another ("BadCo").[55]

As part of the merger, GoodCo and BadCo enter into indemnity and funding agreements wherein BadCo agrees to indemnify and hold harmless GoodCo for any losses arising out of the liabilities it has assumed.[56] GoodCo also agrees to provide funding for BadCo if its assets prove insufficient to satisfy its liabilities or indemnity obligations.[57] Additionally, through a secondment agreement, GoodCo temporarily assigns some of its employees to work for BadCo.[58]

After the merger has been consummated, GoodCo and BadCo reincorporate outside of Texas, with GoodCo primarily incorporating in Delaware to access its favorable body of corporate law and BadCo primarily incorporating in North Carolina, where it is nearly impossible for the bankruptcy court to dismiss the case as having been filed in bad faith.[59] Next, BadCo files for Chapter 11 bankruptcy and requests the court employ its equitable powers under section 105 of the Code to extend the protection of the automatic stay to GoodCo and its other affiliates.[60] Under the Funding Agreement, any action against GoodCo or its affiliates has the potential to adversely affect BadCo's bankruptcy estate and, in turn, hinder its reorganization. After the injunction is granted, the case is then to be resolved in the bankruptcy court, where BadCo attempts to establish a section 524(g) trust funded by its assets and the assets of GoodCo and other affiliates of the entities, who, on account of their contributions are released from liability.

Notably, no Texas Two-Step case has been resolved since the maneuver's inception in 2017, but only one of the four cases employing the maneuver has been dismissed.

III. COURTS ADDRESS CHALLENGES TO THE TEXAS TWO-STEP

To date, courts have addressed challenges to the legitimacy of the Texas Two-Step cases on jurisdictional, good faith, and constitutional grounds. These challenges have been largely unavailing so far, particularly in the Fourth Circuit, where the *Bestwall*, *Aldrich Pump*, and *DBMP* bankruptcies are proceeding.

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55. *See In re* Bestwall LLC, 605 B.R. 43, 47 (Bankr. W.D.N.C. 2019); *Aldrich Pump*, 2021 WL 3729335, at *1; DBMP LLC v. Those Parties Listed on Appendix A to Complaint (*In re* DBMP LLC), No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350, at *1 (Bankr. W.D.N.C. Aug. 11, 2021); *In re* LTL Mgmt., LLC, 64 F.4th 84, 96 (3d Cir. 2023).

56. *See, e.g.*, *Aldrich Pump*, 2021 WL 3729335, at *10.

57. *See, e.g.*, *id.* at *12–16.

58. *See, e.g.*, *id.* at *16.

59. *See* Carolin Corp. v. Miller, 886 F.2d 693, 694 (4th Cir. 1989).

60. *See, e.g.*, *Aldrich Pump*, 2021 WL 3729335, at *23.

A. Challenging the Court's Jurisdiction to Extend the Protection of the Automatic Stay to Non-Debtor Affiliates: In re Bestwall LLC

In *In re Bestwall LLC*,[61] Georgia-Pacific faced tens of thousands of asbestos-related claims, as it had been in the decades since its acquisition of Bestwall Gypsum Co., which manufactured and sold products containing asbestos.[62] Seeing no end in sight to the asbestos litigation, Georgia-Pacific opted to restructure and underwent a Texas divisional merger, splitting into New GP and Bestwall LLC.[63] In the merger, Bestwall received some of Georgia-Pacific's assets and became solely liable for all its asbestos liability, while New GP received all other assets and became liable for all non-asbestos liabilities.[64] Also, as part of the merger Bestwall and New GP entered into numerous funding and indemnity agreements.[65] Following the merger, Bestwall filed Chapter 11 bankruptcy in the Western District of North Carolina.[66]

Notwithstanding the merger, claimants continued to name New GP in their asbestos lawsuits,[67] which led Bestwall to request the court to enjoin all asbestos claims against New GP during Bestwall's bankruptcy.[68] The bankruptcy court granted the injunction under section 105(a) of the Code, noting that allowing claims to proceed would defeat the purposes of the bankruptcy, distract Bestwall's personnel, and that any judgments against New GP would be tantamount to judgments against the bankruptcy estate.[69]

On appeal, the Western District of North Carolina affirmed the bankruptcy court's decision.[70] Next, on appeal to the Fourth Circuit, the court reviewed the propriety of the preliminary injunction both jurisdictionally and on its merits. The claimants argued that by undergoing the Texas Two-Step, old Georgia-Pacific impermissibly sought to manufacture jurisdiction in the bankruptcy court, which is prohibited by 28 U.S.C § 359.[71] The Fourth Circuit disagreed and held

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61. 71 F.4th 168 (4th Cir. 2023).
62. *Id.* at 173, 183.
63. *Id.* at 173–74.
64. *Id.* at 174.
65. *Id.* at 174–75.
66. *Id.* at 175.
67. *Id.* at 174.
68. *Id.* at 176.
69. *Id.* Section 105(a) of the Code in part provides: "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). For a discussion on section 105(a), see Steve H. Nickles & David G. Epstein, *Another Way of Thinking About Section 105(a) and Other Sources of Supplemental Law Under the Bankruptcy Code*, 3 CHAP. L. REV. 7 (2000).
70. *See In re* Bestwall LLC, No. 20-CV-105, 2022 WL 68763, at *1 (W.D.N.C. Jan. 6, 2022).
71. *Bestwall*, 71 F.4th at 180 ("Under 28 U.S.C. § 1359, federal courts do not have jurisdiction over civil actions 'in which any party, by assignment or

that there was no jurisdictional manufacturing because absent the "merger," the court would have had jurisdiction over the claims nonetheless.[72] Only Judge King agreed with the appellants and found that Georgia-Pacific had impermissibly manufactured jurisdiction in his dissent.[73]

The majority seemed to approve of resolving the cases in bankruptcy.[74] It noted that the ensuing delays dwarfed in comparison to those in the tort system[75] and questioned the claimant representative's motives for challenging the bankruptcy proceedings.[76] The majority ultimately concluded that the preliminary injunction was proper on its merits and affirmed the bankruptcy court's decision.[77] The Fourth Circuit later denied rehearing the case en banc.[78]

B. Good Faith Challenges: In re LTL Management, LLC

The most prominent Texas Two-Step case to date is *In re LTL Management, LLC*.[79] In response to tens of thousands of claims from plaintiffs suffering from ovarian cancer and mesothelioma allegedly from using Johnson & Johnson baby powder and other talc-based products,[80] Johnson & Johnson Consumer Inc. ("Old Consumer") underwent the Texas Two-Step.[81] This case involved much more than two steps,[82] but it eventually resulted in two new entities, LTL Management ("LTL") and Johnson & Johnson Consumer Inc. ("New JJCI").[83] LTL received some assets and all of Old Consumer's asbestos liabilities, while New JJCI received most of Old Consumer's valuable

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otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court.'").

72. *Id.* at 181–82.

73. *Id.* at 189–90 (King, J., dissenting).

74. *See id*. at 183 (majority opinion) ("These bankruptcy procedures promote the equitable, streamlined, and timely resolution of claims in one central place compared to the state tort system, which can and has caused delays in getting payment for legitimate claimants.").

75. *Id.* at 183 ("[W]hen Bestwall filed for bankruptcy in 2017, of the 64,000 pending asbestos-related claims, seventy-five percent had been pending for ten years or more, and fifty-five percent had been pending for fifteen years or more.").

76. *Id.* at 184 ("It is not clear why Claimant Representatives' counsel have relentlessly attempted to circumvent the bankruptcy proceeding, but we note that aspirational greater fees that could be awarded to the claimants' counsel in the state-court proceedings is not a valid reason to object to the processing of the claims in the bankruptcy proceeding.").

77. *Id.* at 185.

78. Order, *In re* Bestwall LLC, No. 22-1127 (4th Cir. Aug. 7, 2023).

79. 64 F.4th 84 (3d Cir. 2023).

80. *Id.* at 92–93.

81. *Id.* at 95–96.

82. *Id.* at 96 n.3 (describing the reorganizational steps).

83. *Id.* at 96.

assets.[84] The successors also entered into funding and indemnity agreements like those described above.[85] LTL then incorporated in North Carolina and filed its Chapter 11 petition in the Western District Bankruptcy Court.[86] The court transferred LTL's bankruptcy to New Jersey, finding that LTL had attempted to manufacture venue—likely to be subject to the Fourth Circuit's debtor-friendly dismissal standard and Western District precedent on estimating claims.[87]

After the transfer to New Jersey, the claimants moved to dismiss the case under section 1112(b) of the Code, arguing that the bankruptcy was not filed in good faith.[88] The bankruptcy court denied the motions to dismiss, finding that LTL had filed its bankruptcy in good faith. The court noted that the bankruptcy served a valid reorganizational purpose in seeking to resolve the talc liability and that LTL was in financial distress.[89] Moreover, the court concluded that the use of the Texas Two-Step did not prejudice creditors, eliminated costs, and saw bankruptcy as a superior forum to resolve these claims and protect the claimant's interests.[90] Following this decision, the Third Circuit authorized a direct appeal.[91]

On appeal, the Third Circuit reversed, finding that the bankruptcy court had abused its discretion by denying the motions to dismiss.[92] Under Third Circuit precedent, "two inquiries are particularly relevant: (1) whether the petition serves a valid bankruptcy purpose; and (2) whether it is filed merely to obtain a tactical litigation advantage."[93] The Third Circuit held that absent financial distress, a debtor "cannot demonstrate that its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith."[94] Furthermore, the court held that only LTL's financial condition was determinative,[95] in contrast to the bankruptcy court, which considered the condition of LTL's predecessor and affiliates.[96] The

84. *Id.*
85. *Id.*
86. *Id.* at 97.
87. *In re* LTL Mgmt., LLC, No. 21-30589, 2021 WL 5343945, at *6 (Bankr. W.D.N.C. Nov. 16, 2021).
88. *LTL Mgmt.*, 64 F.4th at 98; *see also In re* Aearo Techs. LLC, No. 22-02890, 2023 WL 3938436, at *9 (Bankr. S.D. Ind. June 9, 2023) (noting that although lack of good faith is not explicitly enumerated in 11 U.S.C. § 1112(b), "most courts generally agree that a case should also be dismissed under § 1112(b) if it was not filed in good faith").
89. *LTL Mgmt.*, 64 F.4th at 98.
90. *Id.* at 99.
91. *Id.*
92. *Id.* at 111.
93. *Id.* at 100–01 (cleaned up).
94. *Id.* at 101.
95. *Id.* at 105.
96. *Id.* at 98–99.

court noted that "property interests are created and defined by state law"[97] and that generally, state law and the Code expect that separate legal entities will be treated as such.[98] Finally, the Third Circuit concluded that, in light of the funding agreements between New JJCI and LTL, which gave LTL access to over $60 billion to satisfy its talc-related costs and normal course expenses, LTL lacked the requisite financial distress to demonstrate that its bankruptcy was filed in good faith.[99]

Hours after LTL had its case dismissed by the Third Circuit, it amended its funding agreement to reduce the amount of capital that LTL could access to $30 billion in an attempt "to place LTL in financial distress."[100] Following the amendments, LTL filed another Chapter 11 petition, which the claimants immediately moved to dismiss.[101] The bankruptcy court found that LTL lacked "imminent and immediate financial distress" and dismissed LTL's second bankruptcy,[102] and on appeal, the Third Circuit affirmed the bankruptcy court's decision.[103] Despite its two failed bankruptcies, Johnson & Johnson unsuccessfully attempted a third Texas Two-Step bankruptcy, this time of its subsidiary Red River Talc LLC in the Bankruptcy Court for the Southern District of Texas.[104]

The Third Circuit's holding in *LTL*, while significant in its own respect, did not affect the ongoing *Bestwall*, *Aldrich Pump*, and *DBMP* cases. In the Fourth Circuit, where those cases are proceeding, courts require "both objective futility and subjective bad faith be shown in order to warrant dismissals for want of good faith."[105] This has shown to be an unachievable task in the Texas Two-Step cases, as courts that have undergone this inquiry have been unable to find that the bankruptcies are objectively futile.[106] Nevertheless, the Bankruptcy Court for the Western District of North Carolina has noted that the Code requires it to assess the debtor's good faith under a less exacting standard if the cases proceed to plan confirmation.[107]

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97. *Id.* at 105 (quoting Butner v. United States, 440 U.S. 48, 55 (1979)).

98. *Id.*

99. *Id.* at 108–10.

100. *In re* LTL Mgmt., No. 23-2971, 2024 WL 3540467, at *2 (3d Cir. July 25, 2024).

101. *Id.*

102. *In re* LTL Mgmt., 652 B.R. 433, 456 (Bankr. D.N.J. 2023).

103. *LTL Mgmt.*, 2024 WL 3540467, at *5.

104. *See* Memorandum Decision and Order, *In re* Red River Talc LLC, No. 24-90505 (Bankr. S.D. Tex. Mar. 31, 2025).

105. *See* Carolin Corp. v. Miller, 886 F.2d 693, 700–01 (4th Cir. 1989).

106. *See, e.g.*, *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *28–29 (Bankr. W.D.N.C. Dec. 28, 2023).

107. *Id.* at *24 (first citing *In re* Bestwall LLC, 605 B.R. 43, 50 (Bankr. W.D.N.C. 2019); and then citing 11 U.S.C. § 1129(a)(3)).

C. Constitutional Challenges: In re Aldrich Pump LLC

In re Aldrich Pump LLC,[108] another ongoing case in the Western District of North Carolina Bankruptcy Court, was the first case to address constitutional challenges to the Texas Two-Step under the Bankruptcy Clause. In this case, the debtors, Aldrich Pump LLC and Murray Boiler LLC are successors to Ingersol-Rand and Trane.[109] After observing the relative success of Georgia-Pacific in *Bestwall*, the debtors opted to engage Georgia-Pacific's legal counsel, Jones Day, and pursue nearly identical divisional mergers and bankruptcy filings.[110] They aimed to address the nearly 90,000 estimated asbestos claims stemming from their climate control products, which were projected to cost the enterprise approximately $547 million.[111] While the divisional mergers largely mirrored those above, the funding agreements condition the solvent affiliates' funding of a section 524(g) trust on them receiving the protections of section 524(g) and automatically terminate upon plan confirmation.[112] These conditions led the bankruptcy court to conclude that these agreements are potentially unenforceable when granting a preliminary injunction to the debtors' affiliates.[113]

Following the injunction, the Official Committee of Asbestos Personal Injury Claimants ("ACC") sought dismissal on constitutional grounds.[114] The ACC argued that as a matter of constitutional law, the debtors' lack of financial distress deprives the bankruptcy court of subject-matter jurisdiction.[115] The ACC contended that under the Bankruptcy Clause of the Constitution, the debtors are not properly "the subject of Bankruptcies."[116] The ACC thoroughly examined the historical record surrounding the Bankruptcy Clause to argue that the Constitution vests power in Congress to deal with the relationship between only insolvent debtors and their creditors.[117] While the ACC noted the difficulty in determining which level of financial distress makes an entity the proper subject of Bankruptcies, it noted that in this case, where the debtors' contracts provide them access to funds equaling one hundred

108. No. 20-30608, Adv. No. 20-03041, 2021 WL 3729335 (Bankr. W.D.N.C. Aug. 23, 2021).

109. *Id.* at *1.

110. *Id.* at *8.

111. *Id.* at *7.

112. *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *8 (Bankr. W.D.N.C. Dec. 28, 2023).

113. *Id.*

114. Motion of the Official Committee of Asbestos Personal Injury Claimants to Dismiss the Debtors' Chapter 11 Cases at 1, *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506 (Bankr. W.D.N.C. Dec. 28, 2023).

115. *Id.* at 2, 20.

116. *Id.* at 29.

117. *Id.* at 20–23.

times their predecessor's most expensive year in asbestos-related costs, that the debtors face no legitimate risk of insolvency and are therefore improper subjects.[118]

The bankruptcy court denied the ACC's motion to dismiss.[119] In its opinion, the court held that the ACC's constitutional arguments were not jurisdictional and that eligibility to file bankruptcy is not a jurisdictional issue.[120] The court explained that "jurisdiction" refers to the court's statutory or constitutional power to adjudicate a case.[121] It further explained that rules and statutes are not jurisdictional without a congressional mandate that they are.[122] Furthermore, the court noted that the Code does not impose a jurisdictional insolvency or financial distress requirement.[123]

Regarding the Bankruptcy Clause, the court held that the Constitution grants Congress authority over the entire subject of bankruptcies, not just an insolvent or distressed debtor's case.[124] Moreover, the court held that since Congress did not include financial insolvency or distress requirements in the Code and because Congress granted district courts extremely broad bankruptcy jurisdiction, questions about the constitutionality of solvent debtors utilizing bankruptcy do not appear to be jurisdictional.[125]

The court further held that although common sense dictates otherwise, a bankruptcy case filed by a solvent, non-financially distressed debtor does not fall outside Congress's constitutional power to legislate on the subject of bankruptcies.[126] The court noted the facial appeal of the argument that solvent, non-distressed businesses should not be afforded the protections of bankruptcy.[127] However, in line with the case law, it held that Chapter 11 is not constitutionally exclusively reserved for insolvent or financially distressed debtors.[128] Notwithstanding its conclusion, the court noted that a solvent debtor is likely to be constitutionally constrained in the relief it can receive in bankruptcy.[129] The court explained that, under the Supreme Court's decision in *Ortiz v. Fibreboard Corp.*, absent insufficient resources to pay claimants, a mandatory "no-opt-out" settlement of a defendant's mass tort liability is unconstitutional in

118. *Id.* at 25–27.
119. *Aldrich Pump*, 2023 WL 9016506, at *4.
120. *Id.* at *12–14.
121. *Id.* at *12.
122. *Id.*
123. *Id.*
124. *Id.* at *13.
125. *Id.* at *13–14.
126. *Id.* at *17–18.
127. *Id.*
128. *Id.* But see Nicholas R. Rader, Comment, *Good-Faith Filings, Solvent Debtors, and the Bankruptcy Clause*, 15 WAKE FOREST L. REV. ONLINE 1 (2025), for a discussion on financial distress as a constitutional limitation.
129. *Aldrich Pump*, 2023 WL 9016506, at *18–21.

class action litigation, as it violates claimants' due process and jury trial rights, and this prohibition likely extends to bankruptcy.[130]

In sum, although jurisdictional, good faith, and constitutional challenges have been largely unable to persuade the bankruptcy courts to dismiss the Texas Two-Step cases so far, the courts will need to consider whether a plan is proposed in good faith and whether its contents are constitutional if the cases ever reach the point of plan confirmation. And, notably, the constitutionality of a solvent entity undergoing bankruptcy is not yet settled.

IV. OTHER CHALLENGES TO THE TEXAS TWO-STEP

In addition to the challenges that courts have addressed regarding the Texas Two-Step Cases, there are several other challenges raised by the claimants that courts have not yet decided. The claimants have moved to substantively consolidate the debtors and their solvent affiliates into a single entity for the purposes of the bankruptcies.[131] Also, they have alleged that the divisional mergers should be set aside as fraudulent transfers and have argued that by undergoing the Texas Two-Step, the debtors have breached the fiduciary duties owed to claimants.[132] While these challenges could prove successful, on balance, substantively consolidating the debtors and their solvent affiliates or dismissing the cases on account of fraudulent transfers or breaches of fiduciary duty would be detrimental to all the parties.

A. Substantive Consolidation & Fraudulent Transfer: In re DBMP LLC

In *In re DBMP LLC*,[133] building products manufacturer CertainTeed Corporation utilized the Texas Two-Step in hopes of resolving its outstanding asbestos liability. Like the debtor in *Aldrich Pump*, CertainTeed, after seeing Georgia-Pacific's relative success, hired Jones Day and underwent its own divisional merger and

130. *Id.* at *19–20.

131. *See* Complaint for Entry of an Order Substantively Consolidating the Estate of DBMP LLC with CertainTeed LLC or, in the Alternative, Reallocating the Asbestos Liabilities of the Debtor to CertainTeed LLC, *In re* DBMP LLC, No. 21-03023 (Bankr. W.D.N.C. Aug. 23, 2021); Complaint for Substantive Consolidation of Debtors' Estates with Certain Nondebtor Affiliates or, Alternatively, to Reallocate Debtors' Asbestos Liabilities to Those Affiliates, *In re* Aldrich Pump LLC, No. 20-30608 (Bankr. W.D.N.C. Oct. 18, 2021).

132. *See* DBMP LLC v. Those Parties Listed on Appendix A to Complaint (*In re* DBMP LLC), No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350, at *23 (Bankr. W.D.N.C. Aug. 11, 2021); Motion of the Official Committee of Asbestos Personal Injury Claimants to Dismiss the Debtors' Chapter 11 Cases, *supra* note 114, at 42–46.

133. No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350 (Bankr. W.D.N.C. Aug. 11, 2021).

bankruptcy in the Western District of North Carolina.[134] The specific facts of the merger largely mirror those of the preceding cases, but notably, the funding agreement in *DBMP* is conditioned on the debtor's solvent affiliates receiving the full protection of section 524(g) of the Code, like the agreement in *Aldrich Pump*.[135] In *DBMP*, the creditors' committee has raised some interesting additional challenges to the propriety of the Texas Two-Step, which differ from those considered in *Bestwall*, *LTL*, and *Aldrich Pump*.[136] The committee has moved to substantively consolidate the estate of the debtor and its affiliate[137] and has alleged that the merger was a fraudulent transfer.[138] Both challenges possess facial appeal and appear meritorious. However, substantively consolidating the debtor and its affiliate or dismissing the bankruptcy on the grounds of fraudulent transfer would ultimately do more harm than good.

1. Substantive Consolidation

"Substantive consolidation, a construct of federal common law, emanates from equity."[139] It allows the bankruptcy court to "combine the assets and liabilities of separate and distinct—but related—legal entities into a single pool and treat them as though they belong to a single entity."[140] Consolidation is not limited to entities in bankruptcy but has been extended to consolidate debtors with non-debtors.[141] "The primary purpose of substantive consolidation 'is to ensure the equitable treatment of all creditors.'"[142] Under the Third Circuit's decision in *In re Owens Corning*,[143] a proponent of substantive consolidation must demonstrate at least one of the following rationales for its application: "that (i) prepetition [the entities] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors."[144]

134. *Id.* at *8–10.

135. *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *8 (Bankr. W.D.N.C. Dec. 28, 2023).

136. I will note that some of these challenges are being pursued in multiple or all of the cases, but I am using the *DBMP* case to illustrate the point.

137. *See* Complaint for Entry of an Order Substantively Consolidating the Estate of DBMP LLC with CertainTeed LLC or, in the Alternative, Reallocating the Asbestos Liabilities of the Debtor to CertainTeed LLC, *supra* note 131.

138. DBMP LLC, 2021 WL 3552350, at *23.

139. *In re* Owens Corning, 419 F.3d 195, 205 (3d Cir. 2005).

140. *In re* Bonham, 229 F.3d 750, 764 (9th Cir. 2000).

141. *Id.* at 765.

142. *Id.* at 764 (quoting *In re* Augie/Restivo, 860 F.2d 515, 518 (2d Cir. 1988)).

143. 419 F.3d 195 (3d Cir. 2005).

144. *Id.* at 211 (citations omitted).

In *DBMP*, the creditors' committee contends that substantive consolidation is warranted to ensure the equitable treatment of all creditors.[145] The committee argues that the non-debtor affiliate is paying their unsecured creditors in the course of business and is improperly paying their equity holders ahead of asbestos claimants.[146] They further claim that due to the Texas Two-Step, asbestos claimants have been "structurally subordinated" to other unsecured creditors and equity holders.[147] They argue that substantive consolidation will place asbestos claimants on equal footing with other unsecured creditors and give them priority over equity holders.[148] Also, the committee contends that substantive consolidation should be ordered *nunc pro tunc* to the petition date, which will, in effect, put the case where it should have been from the outset, with all the assets and liabilities in a single entity, effectively undoing the divisional merger.[149]

The court has not yet issued an opinion regarding the committee's motion for substantive consolidation. However, the court should deny it because substantive consolidation would not benefit the creditors, would burden the court, and would further delay the cases from being resolved. Nevertheless, the facts in *DBMP* may comport with the factual scenarios set out in *Owens Corning* that warrant consolidation. While the entities did disregard separateness, since they were a single company before the merger, the concept of creditor reliance does not neatly encompass tort claimants who have an involuntary relationship with the debtor. Furthermore, in *DBMP*, the assets could reasonably be found to be scrambled in a manner that harms creditors due to the conditional funding agreement between the parties.

Although the criteria for substantive consolidation may be theoretically met, it would, in practice, be detrimental to all parties involved for five reasons. First, its effect would be to create a "behemoth" bankruptcy and significantly increase the complexity, duration, and expense of a case.[150] Second, substantive consolidation would do little for the claimants, as they would remain unsecured creditors, likely placed in a class or classes of their own in either scenario. Third, the accompanying loss to the going concern of GoodCo from being dragged into bankruptcy would ultimately result in fewer assets being available to claimants. Fourth, consolidation would further protract the bankruptcy proceedings and place an even

145. Complaint for Entry of an Order Substantively Consolidating the Estate of DBMP LLC with CertainTeed LLC or, in the Alternative, Reallocating the Asbestos Liabilities of the Debtor to CertainTeed LLC, *supra* note 131, at 3.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.* at 4.

150. *See In re* LTL Mgmt., LLC, 637 B.R. 396, 425 (Bankr. D.N.J. 2022).

greater burden on the court without good reason other than principle alone. Finally, substantive consolidation would not change the debtor's incentives, as in either scenario, it has a limited amount of time to garner the assent of the asbestos claimants or face dismissal or liquidation.

2. Fraudulent Transfer

The Uniform Fraudulent Transfer Act and the Code prohibit transfers made by the debtor "with actual intent to hinder, delay, or defraud any creditor of the debtor."[151] On its face, the Texas Two-Step appears to fit the criteria of a fraudulent transfer, but the analysis may not be as straightforward as it seems.[152] First, under Texas law, a divisional merger is effectuated without any transfer having occurred.[153] While this may seem like a potential issue, the bankruptcy court has noted that the drafters of the divisional merger statute did not intend for it to have any material effect on creditors' rights.[154] Also, if a divisional merger assigns a creditor's claim to an insolvent entity, the creditor will have the right to challenge the merger as a fraudulent transfer.[155]

Next, on the merits, these claims must overcome the existence of the funding agreements that purportedly give the liability-borne successor the same ability to pay its creditors as its predecessor.[156] This seems relatively straightforward in *DBMP* and *Aldrich Pump*, where the solvent affiliates' funding obligation is conditioned on them receiving all the protections of section 524(g) of the Code and automatically terminates on the date of plan confirmation.[157] In effect, these provisions provide the debtors with inferior funding ability compared to their predecessors and arguably indicate an intent to hinder, delay, or defraud creditors and leave the mergers vulnerable to attack as a fraudulent transfer. However, when these provisions are absent, like in *Bestwall*, the creditors' fraudulent transfer challenges seem far less likely to succeed.[158]

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151. TEX. BUS. & COM. CODE ANN. § 24.005(a)(1) (1993); *see also* 11 U.S.C. § 548(a)(1)(A).

152. *See* DBMP LLC v. Those Parties Listed on Appendix A to Complaint (*In re* DBMP LLC), No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350, at *24–26 (Bankr. W.D.N.C. Aug. 11, 2021).

153. TEX. BUS. ORGS. CODE ANN. § 10.008(a)(2)(C) (2015).

154. *DBMP*, 2021 WL 3552350, at *25.

155. *Id.*

156. *See* Parikh, *supra* note 14, at 68–69; *In re* Bestwall LLC, 605 B.R. 43, 49 (Bankr. W.D.N.C. 2019).

157. Aldrich Pump LLC v. Those Parties to Actions Listed on Appendix A to Complaint (*In re* Aldrich Pump LLC), No. 20-30608, Adv. No. 20-03041, 2021 WL 3729335, at *14 (Bankr. W.D.N.C. Aug. 23, 2021).

158. *Bestwall*, 605 B.R. at 49 ("[T]he Funding Agreement exists and is enforceable; it cannot be disregarded.").

Assuming that the Texas Two-Step is a fraudulent transfer, claimants in the Fourth Circuit face yet another obstacle, the "first crack" rule.[159] Under this rule, the debtors-in-possession have exclusive standing to assert fraudulent conveyance claims.[160] This is predicated on the fact that any fraudulently conveyed property belongs to the estate and ensures that creditors cannot "hijack the bankruptcy process."[161] And, given the debtors' close relationship with the non-debtor affiliates, it is unlikely they will challenge their own divisional merger as a fraudulent transfer.[162]

Absent the issues mentioned above, even if claimants obtained derivative standing and brought a successful fraudulent transfer action, it is unclear how this would benefit them. To show that the debtors acted with the intent to hinder, delay, or defraud their creditors in making the transfers, the proponents would need to fully litigate this issue, which would further protract the bankruptcy proceedings.[163] Moreover, if the claimants are successful in challenging the mergers as fraudulent transfers, the remedies in place would do them little service, as undoing the mergers could have the detrimental effects discussed in the preceding section on substantive consolidation.

If the conditional funding agreements in *Aldrich Pump* and *DBMP* do render the divisional mergers as fraudulent transfers which could be "cause" for dismissal under section 1112(b)(4) of the Code,[164] there are arguably "unusual circumstances" which weigh against dismissal under section 1112(b)(2) of the Code.[165] First, if these cases are dismissed, there is good reason to assume that they would quickly end up back in bankruptcy, as it is foreseeable that after dismissal, the parties would simply amend their funding agreements and refile like LTL did after its first case was dismissed.[166]

Second, dismissing the cases and returning them to the tort system works only to subject claimants to the crowded dockets, protracted and repetitive litigation, and high transaction costs that plague asbestos litigation.[167] Asbestos cases take, on average, almost

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159. *DBMP*, 2021 WL 3552350, at *28.

160. *Id.*

161. *Id.* (quoting Nat'l Am. Ins. Co. v. Ruppert Landscaping Co., Inc., 187 F.3d 439, 442 (4th Cir. 1999)).

162. *See id.* at *23.

163. Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. ONLINE 38, 43–44 (2023).

164. 11 U.S.C. § 1112(b)(4).

165. *Id.* § 1112(b)(2).

166. *In re* LTL Mgmt., LLC, 652 B.R. 433, 439–40 (Bankr. D.N.J. 2023).

167. Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 598 (1997) (citing REPORT OF THE JUDICIAL CONFERENCE AD HOC COMMITTEE ON ASBESTOS LITIGATION 2–3 (1991)).

twice as long as other lawsuits.[168] For example, before the *Bestwall* bankruptcy, 75 percent of the 64,000 asbestos-related claims against Bestwall had been pending for at least ten years, and 55 percent had been pending for at least fifteen years.[169] While the Texas Two-Step cases have not proceeded expeditiously, they have been filled with challenges at every step. If any of these cases are ever resolved in bankruptcy, there is good reason to speculate that the establishment of trusts and recovery from them would outpace litigation in the tort system. Finally, dismissal of these cases would result in an enormous deadweight loss, resulting in years of the parties' and court's time, as well as tens of millions of dollars being expended for the parties to exit bankruptcy further apart from a consensual resolution than they were at the outset.

B. Breach of Fiduciary Duty: In re Aldrich Pump LLC

In *Aldrich Pump*, the parties are currently litigating the debtors' alleged breach of fiduciary duty.[170] The claimants argue that the debtor is using its bankruptcy to benefit its insiders and affiliates to the detriment of its creditors.[171] Also, the claimants contend that the bankruptcy allows other creditors to continue to be paid and provides windfalls to equity holders using funds that would otherwise be paid to asbestos claimants.[172] The debtors respond that the claimants are holders of disputed claims with no present interest in any particular asset and state that the funding agreement provides the debtor with the same ability to fund asbestos claims as its predecessor.[173]

The claimant's argument does not specifically delineate the grounds for dismissal other than "cause" under section 1112(b) of the Code.[174] Breach of fiduciary duty is not among the enumerated grounds for dismissal under section 1112(b)(4), but some courts have recognized it as a basis for dismissal.[175] The claimants could argue that because of the alleged breach, there has been a substantial loss to the estate and that there is an absence of a reasonable likelihood

168. Ortiz v. Fibreboard Corp., 527 U.S. 815, 866 (1999) (Breyer, J., dissenting) (citing REPORT OF THE JUDICIAL CONFERENCE AD HOC COMMITTEE ON ASBESTOS LITIGATION 10–11 (1991)).

169. *In re* Bestwall LLC, 71 F.4th 168, 183 (4th Cir. 2023).

170. *See In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *31 (Bankr. W.D.N.C. Dec. 28, 2023).

171. *Id.* at *29.

172. Motion of the Official Committee of Asbestos Personal Injury Claimants to Dismiss the Debtors' Chapter 11 Cases, *supra* note 114, at 43.

173. Debtors' Objection to Motion of Official Committee of Asbestos Personal Injury Claimants to Dismiss Debtors' Chapter 11 Cases at 22, *In re Aldrich Pump LLC*, 2023 WL 9016506 (No. 20-30608).

174. *See* Motion of the Official Committee of Asbestos Personal Injury Claimants to Dismiss the Debtors' Chapter 11 Cases, *supra* note 114, at 42–46.

175. *In re* V Cos., 274 B.R. 721, 726 (Bankr. N.D. Ohio 2003).

of rehabilitation, or they may argue that the estate has been grossly mismanaged. Both of these arguments utilize recognized grounds for dismissal in section 1112 of the Code.[176]

One issue with the claimants' breach of fiduciary duty claim is that it seems to mirror the good faith challenge that has already been decided in the debtors' favor.[177] Additionally, it appears to be dependent on the success of a fraudulent transfer claim. Therefore, while arguing the debtor has breached its fiduciary duty seems to be a distinct and viable standalone claim, it appears to be inextricably intertwined with the good faith and fraudulent transfer challenges.

In sum, while there may be legitimate grounds for the court to substantively consolidate the debtors and their solvent affiliates or dismiss the cases for fraudulent transfer or breach of fiduciary duty, the success of these challenges is questionable, and it is difficult to see how substantive consolidation or dismissal would benefit the claimants.

V. THE TEXAS TWO-STEP CASES SHOULD BE RESOLVED IN BANKRUPTCY

Businesses employing the Texas Two-Step and attempting to resolve their asbestos liabilities in bankruptcy do not inherently harm claimants. Resolution of the asbestos claims in bankruptcy is the optimal outcome for all parties involved. While the debtors' envisioned global resolution is likely unfeasible due to constitutional concerns, establishing bankruptcy trusts that allow claimants to opt out still presents a viable solution to efficiently resolve thousands of asbestos claims, protect the claimants' constitutional rights, save the parties millions of dollars in litigation expenses, and expedite the recovery of numerous claimants.

A. The Texas Two-Step Does Not Harm Claimants

A business undergoing a divisional merger and seeking to resolve its tort liability in bankruptcy does not inherently prejudice its claimants by placing assets out of their reach. Generally, the funding agreement provides a debtor with the same ability to pay claimants as its predecessor,[178] and the continued and unencumbered operation of the debtor's solvent affiliate only works to increase the pool of funds available to claimants. While the conditional funding agreements in *Aldrich Pump* and *DBMP* do not provide the debtors with the same

176. 11 U.S.C. § 1112(b)(1)–(2), (4).

177. *See In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *29 (Bankr. W.D.N.C. Dec. 28, 2023).

178. *In re* Bestwall LLC, 605 B.R. 43, 49 (Bankr. W.D.N.C. 2019) ("Bestwall has the full ability to meet all of its obligations (whatever they may be) through its assets and New GP's assets, which are available through the Funding Agreement, and to continue as a going concern." (citation omitted)).

funding abilities as their predecessors, absent those conditions, the mergers do not harm the claimants. Hopefully, the funding agreements can be amended so the cases can remain in bankruptcy and avoid the major deadweight losses that would accompany dismissal.

While critics have argued that the funding agreements are unsecured and unguaranteed, thereby placing the risk of the solvent affiliates facing future insolvency onto the victims,[179] the possibility of this risk is not sufficient cause for concern. First, a major challenge to these cases has been that the debtors' solvency makes them "ineligible" for bankruptcy.[180] Moreover, if after the cases are resolved, the solvent affiliates face insolvency, the courts can employ equitable remedies to ensure that the victim's claims receive priority.[181] Additionally, as discussed below, while a trust may be able to capture future claims, it is unlikely that it will be able to hold them hostage.

Next, resolving the cases in bankruptcy does not deprive the claimants of leverage in negotiations or give the debtors free reign to coerce the claimants into accepting unfavorable settlements. While a successful Texas Two-Step could provide financial upside to the debtors, it also poses significant downside risks like negative public perception (which could have negative consequences if these cases ever go before a jury) and the significant associated costs of employing bankruptcy professionals. By utilizing bankruptcy, the debtors have subjected themselves to greater court oversight in negotiating a settlement than in the tort system. Typically, to utilize a section 524(g) trust, a debtor must obtain the approval of 75 percent of the claimants and have the plan approved by both the bankruptcy and district courts.[182] These protections ensure that a debtor seeking a "bankruptcy discount" will be unable to resolve its case because it must offer sufficient compensation to garner the assent of a supermajority of claimants and be approved by multiple courts. And, as discussed below, in Texas Two-Step cases, the debtors' solvency may necessitate even greater creditor protections and likely allows a debtor to channel claims to a trust only with the claimant's consent. Additionally, claimants can still use the possibility of a jury trial as leverage in the bankruptcy negotiations, as once a debtor files bankruptcy, it has a limited amount of time to propose and consummate a plan of reorganization or face dismissal or

179. Parikh, *supra* note 14, at 69.

180. *See Aldrich Pump*, 2023 WL 9016506, at *12.

181. 11 U.S.C. § 510(c) permits the court, after notice and hearing, to equitably subordinate "an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or . . . order that any lien securing such subordinating claim be transferred to the estate."

182. 11 U.S.C. §§ 524(g)(2)(B)(ii)(IV)(bb), 524(g)(3), 1129(a).

conversion.[183] Either outcome—dismissal or conversion—would presumably allow the claimants to resume their lawsuits in state or federal courts and exercise their right to a jury trial.

The protracted timeline that has ensued in these cases is unfortunate, but it is not due to the debtors having no incentive to resolve the case or a tactic by the debtors to "delay and discount."[184] Rather, it stems from the complex nature of resolving tens of thousands of asbestos claims and the numerous delays caused by claimants challenging the bankruptcies or refusing to engage in negotiations.[185] Also, prior to the bankruptcies, many claimants had spent a decade or more in the tort system with no progress.[186] The debtors are incentivized to resolve the cases as quickly as possible because employing the Texas Two-Step has proved to be an extremely expensive endeavor.[187] Additionally, the debtors have strong incentives to avoid dismissal or conversion as either would result in the businesses expending tens of millions of dollars pursuing resolution in bankruptcy, only to exit no better off, still facing tens of thousands of claims and massive litigation costs.[188] In sum, claims that the Texas Two-Step is being used to "evade accountability"[189] or as a tactic to "delay and discount"[190] overlook the costs the debtors face, the extent of the creditor protections and leverage present in the bankruptcy system, as well as the debtors' incentives to resolve the cases in a timely manner.

B. Limited Resolution in Bankruptcy Is the Optimal but Unlikely Outcome

Although constitutional limitations will likely prevent any debtor from effectuating a global settlement of their asbestos liability, a limited resolution in bankruptcy that creates a settlement trust is the best possible outcome. In these cases, the asbestos claimants have a due process property right in their claims and the right to a jury trial

183. 11 U.S.C. §§ 1112, 1121.

184. Judith K. Fitzgerald & Adam Levitin, *The Texas Two-Step's Liquidation Problem*, CREDIT SLIPS (Jan. 15, 2023), https://perma.cc/59YD-NHPC.

185. *In re* Aldrich Pump, No. 20-30608, 2023 WL 9016506, at *32 (Bankr. W.D.N.C. Dec. 28, 2023).

186. *See supra* text accompanying note 169.

187. Rick Mitchell, *Wake Up Call: Jones Day's Texas Two-Step Take at $107 Million*, BLOOMBERG L. (Feb. 13, 2023), https://perma.cc/6XGA-ABZ4.

188. *See* DBMP LLC v. Those Parties Listed on Appendix A to Complaint (*In re* DBMP LLC), No. 20-30080, Adv. No. 20-03004, 2021 WL 3552350, at *6 (Bankr. W.D.N.C. Aug. 11, 2021); Aldrich Pump LLC v. Those Parties to Actions Listed on Appendix A to Complaint (*In re* Aldrich Pump LLC), No. 20-30608, Adv. No. 20-03041, 2021 WL 3729335, at *6 (Bankr. W.D.N.C. Aug. 23, 2021).

189. *Evading Accountability: Corporate Manipulation of Chapter 11 Bankruptcy*: *Hearing Before the S. Comm. on the Judiciary*, *supra* note 12.

190. Fitzgerald & Levitin, *supra* note 184.

under the Fifth Amendment and Seventh Amendment.[191] While section 524(g) of the Code does attempt to account for constitutional concerns by requiring the assent of 75 percent of the claimants whose claims are to be addressed by a bankruptcy trust and appointing a future claims representative, the typical justification for infringing on the claimant's rights—a limited amount of funds—is simply not present when a debtor is solvent.[192] In an order in *Aldrich Pump*, Judge Whitley expressed these concerns and noted that under the Supreme Court's class action jurisprudence, "a mandatory 'no-opt-outs' settlement of a defendant's aggregate mass-tort liability is unconstitutional if the defendant's resources are sufficient to fully pay all the claims."[193] Judge Whitley also noted that, by statute, bankruptcy courts lack jurisdiction to determine personal injury claims and cannot deprive claimants of their jury trial rights.[194]

While the Court's class action jurisprudence is not binding in the bankruptcy context, it is highly persuasive due to the striking similarities in the aggregate resolution processes in class actions and bankruptcies. Both scenarios result in future claimants being deprived of their due process right to opt out and all claimants being deprived of their rights to a jury trial.

Notably, debtors have proposed methods that attempt to work around the right to a jury trial by allowing claimants who have exhausted their rights under the trust distribution procedures to retain the right to sue the trust in the tort system.[195] However, these methods are inadequate and work to protect the claimants' constitutional rights only in form and not in substance. Future claimants still lose their right to opt out, and claimants who wish to litigate must pursue their claims against the trust rather than the debtor.[196] Additionally, claimants who prevail in their suits against the trust are limited in their recovery and are only eligible to receive the maximum value of their claim as calculated by the trust distribution procedures.[197] While this result may seem constitutionally permissible and allowed under the Code where the requisite 75 percent consent is obtained, this seems to be an appropriate situation for a bankruptcy court to exercise its equitable powers "to the end . . . that substance will not give way to form [and]

191. *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *19 (Bankr. W.D.N.C. Dec. 28, 2023).

192. Ortiz v. Fibreboard Corp., 527 U.S. 815, 838 (1999).

193. *Aldrich Pump*, 2023 WL 9016506, at *19–20 (emphasis in original) (citing *Ortiz*, 527 U.S. at 817–18).

194. *Id.* at *19 (citing 28 U.S.C. §§ 157(b)(1), 1411(a)).

195. *See* Trust Distribution Procedures § 6.1.3, *In re* Red River Talc LLC, (Bankr. S.D. Tex. Sept. 20, 2024) (No. 24-90505).

196. *See id.*

197. *Id.*

that technical considerations will not prevent substantial justice from being done."[198]

In light of these constitutional concerns, it seems that if a solvent debtor wishes to establish a bankruptcy trust, it likely may only do so consensually, effectively closing the door on the debtors being able to bind dissenters and future claimants.[199] Still, the debtors can use bankruptcy trusts as vehicles to effectuate mass settlements with current claimants and provide future claimants with a more efficient path to recovery.

The broad jurisdiction of bankruptcy courts allows them to capture ongoing state and federal claims in a single forum, and the automatic stay allows the court to halt litigation so the parties can attempt to negotiate mass settlements.[200] In these cases, the debtors have expressed their intent to pay the full value of claims through the establishment of bankruptcy trusts. Although a Texas Two-Step Chapter 11 plan would likely be required to allow unwilling claimants to opt out of the plan, and some disagreement on the valuation of claims is inevitable, the typical human tendency of risk aversion suggests that many claimants would be willing to accept such a proposal,[201] especially considering the speed premium, reduced expenses, and more predictable outcomes offered by recovery through the trusts compared to litigation.[202]

Allowing claimants to opt out could also prove beneficial for the willing participants, as it would presumably allow the bankruptcies to proceed with far fewer challenges by allowing claimants who do not wish to participate to remove themselves. While permitting the claimants who opt out to pursue their claims while the bankruptcies are ongoing would run afoul of the automatic stay—a fundamental element of bankruptcy—ideally, courts would take a balanced approach and grant relief on an ad hoc basis in cases with sick

198. Pepper v. Litton, 308 U.S. 295, 305 (1939). While the Court in *Ortiz* did recognize that exceptions to due process have been recognized where "a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants, as for example in bankruptcy," it noted that "the burden of justification rests on the exception." Ortiz v. Fibreboard Corp., 527 U.S. 815, 846 (1999) (quoting Martin v. Wilks, 490 U.S. 755, 762 n.2 (1989)). In cases where the debtor is not insolvent, it seems difficult to justify excepting such fundamental rights.

199. While what exactly constitutes a "consensual resolution" is outside of the scope of this Comment, I nevertheless acknowledge the scholarly debate surrounding whether consent requires an opt-in or opt-out scheme and recognize that it will be an important issue in the resolution of current and future mass tort bankruptcies. *See* Evan Ochsner, *Purdue Ruling Tees Up 'Consent' Question for Bankruptcy Courts*, BLOOMBERG L. (July 2, 2024), https://perma.cc/9SDA-5884.

200. *See supra* Part I.

201. Keith N. Hylton, *Mutual Optimism and Risk Preferences in Litigation*, 75 INT'L REV. L. & ECON. 1, 1–2 (2023).

202. *In re* LTL Mgmt., LLC, 637 B.R. 396, 415 (Bankr. D.N.J. 2022).

claimants where time is of the essence. For example, courts could consider the potential harm to the estate of allowing the litigation to proceed, the necessity of the claimants requesting relief from the stay, and any other relevant factors in making this determination.

For future claimants, the establishment of bankruptcy trusts could also prove to be beneficial. While it is unlikely that future claimants can be bound by the Chapter 11 plan and prevented from pursuing their claims in the tort system, if trusts were established, ideally, they would capture future claims, but claimants would retain the right to opt out and pursue their claims in the tort system, thus preserving their constitutional rights. Furthermore, to ensure balanced recoveries among claimants who recover from the trusts, the debtors and their affiliates who receive protection should be continuously obligated to ensure that the trusts are adequately funded. Even if large numbers of claimants do opt out, if only half of the current and future claimants choose to pursue recovery from the trusts, they would still allow numerous claimants to recover without burdensome and protracted litigation, save the debtors millions of dollars in litigation expenses, and remove tens of thousands of asbestos claims from the tort system.

However, practically speaking, allowing claimants to opt out could quickly cause the bankruptcies to fall apart. If a large number of claimants, especially those with the highest value claims, choose to opt out, it would erode the efficiency and undermine the value preservation associated with resolution through the establishment of bankruptcy trusts. While it is difficult to draw a line of demarcation, it seems possible that if too many claimants opt out, the combined costs of establishing bankruptcy trusts and litigating in the tort system could result in the debtors incurring greater expenses than they would have had they never undergone the Texas Two-Step. And, considering that a small number of plaintiff's lawyers represent a large number of claimants[203] and are financially incentivized to pursue claims in the tort system,[204] this may be the likely outcome.[205] Nevertheless, this seems to be what the Constitution commands when

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203. Lester Brickman, *Ethical Issues in Asbestos Litigation*, 33 HOFSTRA L. REV. 833, 868–69 (2005).

204. *See In re* Bestwall LLC, 71 F.4th 168, 184 (4th Cir. 2023) ("It is not clear why Claimant Representatives' counsel have relentlessly attempted to circumvent the bankruptcy proceeding, but we note that aspirational greater fees that could be awarded to the claimants' counsel in the state-court proceedings is not a valid reason to object to the processing of the claims in the bankruptcy proceeding.").

205. *In re* Aldrich Pump LLC, No. 20-30608, 2023 WL 9016506, at *32 (Bankr. W.D.N.C. Dec. 28, 2023) ("The ACC and the claimant law firms will not 'go gentle into that good night.' Dylan Thomas, *The Poems of Dylan Thomas* (New Directions Pub. 1971). Rather, at every opportunity they have sought to force dismissal of these cases.").

solvent businesses attempt to use bankruptcy to resolve their outstanding mass tort liability.

CONCLUSION

Over twenty-five years ago, Justice Souter described asbestos litigation as an "elephantine mass . . . [which] defies customary judicial administration and calls for national legislation."[206] In the years since, no legislation has been passed, and numerous sellers and manufacturers of products containing asbestos have gone bankrupt. Congress has not weighed in on the issue of asbestos litigation since it codified the use of bankruptcy trusts in asbestos cases in section 524(g) of the Code. In recent years, highly solvent businesses have attempted to manage their asbestos liability utilizing section 524(g) with a twist, the Texas Two-Step. While the Texas Two-Step is controversial, many of the concerns surrounding it are speculative and overlook the protections of the bankruptcy system and the debtors' incentives to effectuate a timely resolution of the cases.

In theory, businesses can utilize the Texas Two-Step to resolve their asbestos liability equitably and efficiently, without needlessly harming their primary enterprise, thus fulfilling the twin objectives of Chapter 11 of preserving going concerns and maximizing the amount of property available to creditors. Although constitutional concerns and practical limitations will likely prevent any case from ever being resolved, in theory, the Texas Two-Step could be used to effectuate settlements that make claimants whole, protect their constitutional rights, reduce the debtors' litigation expenses, and divert some of the "elephantine mass" away from the tort system. However, "[t]heory will take you only so far."[207]

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206. Ortiz v. Fibreboard Corp., 527 U.S. 815, 821 (1999).

207. OPPENHEIMER (Universal Pictures 2023).

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