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DIVISIVE MERGERS AND THE TEXAS TWO-STEP

Using J&J as an example in this article, the authors defend J&J's use of a "divisive merger," with a bankruptcy filing as the second step, as a proper exercise of the bankruptcy process that promotes the public interest. They begin by describing the mechanics of the divisive merger strategy in detail, using examples. They then turn to divisive mergers as fraudulent transfers, again giving an example. They close by addressing possible jurisdictional splits on several issues, cite proposed federal legislation designed to curtail divisive mergers, and note four other states with divisive merger statutes.

By Jeffrey R. Gleit and Matthew R. Bentley *

The prominent bankruptcy case involving an affiliate of Johnson & Johnson ("J&J") is well under way. For those unaware, J&J's woes are tied to substantial mass tort litigation involving injuries arising from J&J's talc-based products, most notably its popular baby powder brand. Claimants allege that exposure to these products caused cancer in thousands of consumers due to the presence of certain carcinogenic ingredients. The total cost of this mass tort litigation is unclear, but estimates have reached as high as \$190 billion, and until recently, J&J and its affiliates were spending between \$10 million and \$20 million every month in defense costs.¹

¹ See LTL Management LLC, 21-ap-03032, Dkt. No. 1, ¶ 36 ("In the months prior to the Petition Date, Old JJCI was paying anywhere from \$10 million to \$20 million in monthly defense costs."); see also Vince Sullivan, "Ch. 11 For J&J Talc Unit Only Wise Choice, Top Lawyer Says," LAW360 (February 15, 2022) <https://www.law360.com/newjersey/articles/1465375/ch-11-for-j-j-talc-unit-only-wise-choice-top-lawyer-says> (last visited May 10, 2022) ("[the Debtor's Chief Legal Officer] said earlier that if all 38,000 talc claims were litigated through trial,

Companies using bankruptcy to mitigate the onerous costs of mass tort liability is nothing new (e.g., Johns-Manville, A.H. Robins, Boy Scouts of America, USA Gymnastics, etc.), but the bankruptcy strategy employed by J&J has given this case a level of notoriety and scrutiny that most bankruptcy cases avoid. This strategy is called "the Texas Two-Step," so named because the cornerstone is an election in Texas law known as the "divisive merger." Through this strategy, a company like J&J may allocate the liabilities that underlie mass tort litigation away from the profitable enterprise and into a subsidiary, which is now on the hook for those liabilities. The subsidiary will then file for bankruptcy, and once in bankruptcy all litigation arising from the liabilities will be subject to the automatic stay and the debtor will likely seek and obtain a temporary injunction to protect non-debtor defendants like J&J. This means that the litigation against J&J, currently comprising

footnote continued from previous column...

it would cost J&J as much as \$190 billion just in legal expenses.").

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