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J&J Talc Lawsuits Transferred to New Jersey—A Look into the Texas Two-Step Maneuver

By Douglas S. Mintz and Kelly (Bucky) Knight*

The authors explain that courts ultimately will determine the long-term viability of the "Texas Two-Step," but as of now bankruptcy courts will consider the purposes and conditions of a company's creation to determine whether venue has been artificially manufactured.

Last November, in *In re LTL Mgmt. LLC*,[1] Bankruptcy Judge Craig Whitley in Charlotte, North Carolina, ordered LTL Management LLC's Chapter 11 bankruptcy case moved to New Jersey after finding that LTL Management had used the "Texas Two-Step" to manufacture jurisdiction in North Carolina improperly. LTL Management is a subsidiary of Johnson & Johnson ("J&J") and a defendant in thousands of talc-related tort claim lawsuits.

Courts will determine the long-term viability of the "Texas Two-Step" through cases such as *LTL Management*. What we know now is that bankruptcy courts will consider the purposes and conditions of a company's creation to determine whether venue has been artificially manufactured.

THE TEXAS TWO-STEP

Two days before the filing of this Chapter 11 case, former J&J subsidiary Johnson & Johnson Consumer Inc. ("Old JJCI") split into two separate Texas LLCs through a divisive merger under Texas business law. Old JJCI transferred all its talc-related liabilities to one of the two new entities, forming LTL Management.

LTL Management then converted into a North Carolina LLC before filing for Chapter 11 in Charlotte, North Carolina. Old JJCI also placed the majority of its assets into the other new entity, which changed its name to Johnson & Johnson Consumer Inc. and merged into J&J. Old JJCI ceased to exist after these transactions.

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[1] *In re LTL Mgmt. LLC*, No. 21-30589 (Bankr. D.N.J. Nov. 16, 2021).

Companies threatened with mass tort litigation have used this controversial restructuring strategy, also known as the "Texas Two-Step," to isolate their exposure. Rather than placing the entire corporate structure into bankruptcy, companies use Texas's divisional merger law to split the subsidiary holding toxic assets in two. Liabilities are offloaded into one of the two resulting entities and all remaining valuable assets are assigned to the other. The entity holding the liabilities then files for bankruptcy. This strategy could enable companies to resolve their mass tort liability through a Chapter 11 reorganization while shielding the bulk of their assets from tort claimants.

Critics of the Texas Two-Step argue that it is an abusive practice designed to derail lawsuits by forcing claimants to seek recovery from an artificially underfunded entity. Those same critics also argue that the Texas Two-Step encourages forum shopping for more favorable bankruptcy jurisdictions.

LTL MANAGEMENT TRANSFER ORDER

After executing its Texas Two-Step transaction, LTL Management filed for bankruptcy in the Western District of North Carolina. The bankruptcy administrator for the Western District of North Carolina moved to transfer venue of the Chapter 11 case to the District of New Jersey shortly after the bankruptcy filing. (In North Carolina, bankruptcy administrators perform functions traditionally completed by U.S. Trustees in most locales.)

The bankruptcy administrator argued that, although venue may have been proper in North Carolina, transfer of venue served the interest of justice because the debtor "created facts to fit the statute." Therefore, the court need not grant deference to the debtor's choice of venue. The bankruptcy administrator also argued that the convenience of the parties weighed in favor of transfer of venue to the District of New Jersey because of the related multi-district litigations pending against the debtor.

The debtor objected to this motion.

Convenience to the Parties

Bankruptcy courts balance six factors when determining whether a transfer of venue is convenient to the parties:

(1) The proximity of creditors of every kind to the court;

(2) The proximity of the debtor to the court;

(3) The proximity of the witnesses necessary to the administration of the estate;

(4) The location of the assets;

(5) The economic administration of the estate; and

(6) The necessity for ancillary administration if a liquidation should occur.

The movants explained how each convenience factor weighed in favor of transfer, arguing, among other things, that the related multi-district litigations pending against the debtor in New Jersey, the debtor's continuing connections to New Jersey, the location of relevant witnesses and the debtor's principal assets in New Jersey all support a transfer of venue.

The debtor opposed the transfer, focusing primarily on the fifth factor. The debtor argued that, "[g]iven the Court's extensive experience with mass tort cases, and divisional merger cases in particular, the 'economic and efficient administration of the estate' factor . . . unquestionably weigh[ed]" against transfer.

The debtor also argued that this case is similar to two prior North Carolina bankruptcy cases where the court declined to transfer venue: *Kaiser Gypsum Co., Inc.* and *Bestwall LLC*.[2]

In *Kaiser*, the court held that no other venue was inherently more favorable because interested parties and claimants were scattered across the country.

Judge Whitley distinguished this case from *Kaiser* because "[t]he Debtor's parent company and key witnesses are located in New Jersey, and most of the interested parties and claimants are currently involved in proceedings pending in the District of New Jersey."

Judge Whitley also distinguished this case from *Bestwall* based on timing of the transfer request. In *Bestwall*, the movants filed the motion to transfer nearly two years after the petition date. The *Bestwall* court denied the request because a new judge would incur significant additional costs in learning the facts and relevant law of the case. Here, Judge Whitley reasoned that "additional learning curve costs for a new judge are not as great" in LTL Management's case because it was less than a month old at the time of the transfer request.

Ultimately, because the overwhelming majority of talc-related litigation against LTL Management is pending in a New Jersey multi-district litigation, Judge Whitley reasoned that factors one and five support the transfer.

Interest of Justice

When deciding whether a transfer of venue meets the interest of justice, bankruptcy courts consider (1) whether the transfer promotes the efficient

[2] *In re Kaiser Gypsum Co., Inc.*, No. 16-31602 (Bankr. W.D.N.C. Jan. 30, 2017); *In re Bestwall LLC*, 605 B.R. 43, 51 (Bankr. W.D.N.C. 2019).

administration of the bankruptcy estate, judicial economy, timeliness and fairness, and, (2) whether the debtor is forum shopping.

The movants argued that the interest of justice necessitated transfer because "unreasonable forum shopping" is a factor in whether the interest of justice demands transfer or deference to the debtor's choice of venue. According to the movants, the debtor's actions taken in pursuit of forum selection were even more aggressive than in similar cases in which the courts granted transfer motions in the interest of justice.

The debtor again argued that because the court had experience in these types of cases, that alone was enough to dictate that the interest of justice weighed against transfer of venue. According to the debtor, the most important factor is the economic and efficient administration of the estate, which the court's expertise in mass tort and divisional merger cases promotes.

Judge Whitley held that transferring the case to New Jersey served the interest of justice because LTL Management used the Texas Two-Step to manufacture venue in a location where it lacked venue otherwise. Judge Whitley noted that LTL Management only existed for two days in North Carolina prior to filing for bankruptcy, suggesting that LTL Management "subjected itself to the laws of North Carolina purely for the purpose of filing bankruptcy."

Judge Whitley analogized the case to *Patriot Coal Corp.*, where the debtor formed two New York shell companies just weeks prior to the petition date, allowing 97 affiliates across the country to file for bankruptcy in the Southern District of New York.[3] The debtor tried to distinguish *Patriot Coal*, arguing that LTL Management is not a shell company because it has substantial assets. Judge Whitley rejected these arguments, finding that while LTL Management may have assets, "they were all created to effectuate a bankruptcy filing and have no other business purpose."

Judge Whitley concluded his opinion stating "[t]here is no reason this Court should be the only bankruptcy court to have the opportunity to weigh in on these novel issues, especially considering that the 'Texas Two Step' tactic is being employed by national corporations and impacts tens of thousands of present and future claimants across the country."

TAKEAWAYS

Because this court criticized the Texas Two-Step and viewed it as a strategy to manufacture venue, parties should watch this case closely. The New Jersey

[3] *In re Patriot Coal Corp.*, 482 B.R. 718 (Bankr. S.D.N.Y. 2012).

bankruptcy court's further consideration of the strategy could negate the impact of this approach. Additionally, Judge Whitley's ruling suggests that the Western District of North Carolina may no longer offer a friendly venue for this strategy—one that parties have used dating back to the 1990s with respect to asbestos liabilities.

However, objecting parties should seek to transfer venue shortly after the commencement of a Texas Two-Step case. Allowing the case to proceed for too long will make a transfer less likely because a new judge will inevitably require more time and incur greater costs to learn the facts and relevant law of the case.