

Texas Twists in M&A: The Latest and Greatest

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Moderator:

Samantha Crispin, Baker Botts L.L.P., Dallas, Texas

Panelists:

Byron Egan, Jackson Walker LLP, Dallas, Texas

Robert R. Kibby, Munsch Hardt Kopf & Harr, P.C., Dallas, Texas

Chauncey Lane, Holland & Knight LLP, Dallas, Texas

Mark Solomon, Katten Muchin Rosenman LLP, Dallas, Texas



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Agenda

- Divisive Mergers
- Fiduciary Duties
- Express Negligence
- Successor Liability
- Sandbagging
- Non-reliance
- Best Efforts

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Texas Twists – Divisive Mergers

- Texas law has since 1989 authorized a corporation, partnership or LLC to effect a “divisive merger” by which a single entity can adopt a plan of merger pursuant to which it divides its assets and liabilities among one or more new or existing entities. Delaware statutes were amended in 2018 and 2019 to authorize LLCs and LPs, respectively, to effect “divisions” which are comparable to divisive mergers, but has thus far not allowed corporations or other entities to effect divisions.
- Delaware lawyers have for years redomiciled Delaware corporations to Texas to effect divisive mergers – called by media a “Texas Two Step.” In one case to be discussed later the resulting Texas entities were converted elsewhere after only four few hours – one to Delaware and one to North Carolina to file for bankruptcy there to take advantage of favorable Fourth Circuit bankruptcy precedent.

Texas Twists – Divisive Mergers

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- The Texas divisive merger analysis begins with Texas Business Organizations Code (“TBOC”) § 1.002(55) which defines “merger” to mean “(A) 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.”
- A divisive merger under the TBOC can involve any combination of corporations, partnerships or LLCs, including professional entities, but all of them would need to be organized under the TBOC or the laws of another state which permits divisive mergers. Among the states that authorize divisive mergers are Arizona, Delaware, Pennsylvania, and Texas.
- The plan of merger for a divisive merger under the TBOC must provide, among other things, the manner and basis for allocating and vesting the assets and liabilities of the parties, making adequate provision for the payment and discharge of each liability or obligation. Additionally, the plan of merger should address contingent assets and contingent liabilities of the parties.

Texas Twists – Divisive Mergers

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- TBOC § 10.008(a)(4) provides that, upon the effectiveness of a merger, “each surviving or new domestic organization to which a liability or obligation is allocated under the plan of merger is the primary obligor for the liability or obligation, and, except as otherwise provided by the plan of merger or by law or contract, no other party to the merger, other than a surviving domestic entity or non-code organization liable or otherwise obligated at the time of the merger, and no other new domestic entity or non-code organization created under the plan of merger is liable for the debt or other obligation. . .” If, however, the plan of merger fails to provide for the allocation or vesting of any particular item of property or any liability of any party to the merger, TBOC § 10.008(b) provides that “the unallocated property is owned in undivided interest by, or the liability or obligation is the joint and several liability and obligation of, each of the surviving and new organizations, pro rata to the total number of surviving and new organizations resulting from the merger.”

Texas Twists – Divisive Mergers

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- TBOC § 10.008(a) provides in relevant part that when a merger takes effect, all of the properties of the constituent entities are vested in the surviving entity without “any transfer or assignment having occurred.” A literal reading of these TBOC provisions was given by a Texas Court of Appeals in *TXO Prod. Co. v. M.D. Mark*, 999 S.W. 2d 137 (Tex. App. - Houston [14th Dist.] 1999, pet. denied), in holding that a merger is not a “transfer.” The Sixth Circuit, in *Cincom Sys., Inc. v. Novelis Corp.*, 581 F. 3rd 431 (6th Cir. 2009), held under the similar Ohio statute that in the context of patent licenses or trade secrets, a “transfer” occurs under federal law any time an entity other than the one to which the license was expressly granted gains possession of the license.
- A divisive merger under the TBOC may alter and reduce the pool of assets to which a creditor may look to for repayment. If a claim of a creditor of one entity in a divisive merger is allocated to a different or new entity in the merger, that creditor will generally only be entitled to look to the entity to which its claim is allocated and not to each surviving entity. The creditor, however, will continue to possess all the rights otherwise available to it under law (including fraudulent transfer laws) and contract, including all security interests in the property of the debtor securing the payment of the creditor’s claim.

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