The Texas Two Step: What's all the Fuss About?

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Mr. Egan regularly writes and speaks about the areas in which his law practice is focused, and is the author of *EGAN ON ENTITIES: Corporations, Partnerships and Limited Liability Companies in Texas* (4th Ed. 2023), which addresses the formation, governance and sale of business entities, including an analysis of the fiduciary duties of their governing persons in a variety of situations, and numerous other publications and is available here.

Divisive mergers are discussed in *EGAN ON ENTITIES Corporations, Partnerships and Limited Liability Companies in Texas* (4th Ed. 2023) § 1.4.3 on pages 29-37 and fraudulent transfers are discussed in § 2.6.9(g) on pages 263-266.

Outline

I. Wikipedia

- Texas Two Step Bankruptcy:
  - A Texas two-step bankruptcy is a two-step bankruptcy strategy under US bankruptcy law in which a solvent parent company spins off liabilities into a new company, and then has that new company declare bankruptcy. In the first step, the parent company undergoes a Texas divisive merger, which allows companies to split off their liabilities from their assets. In the second step, the newly created spin-off declares a chapter 11 bankruptcy, usually in North Carolina, where bankruptcy courts are perceived to be more open to this scheme. The Texas two-step allows solvent companies to shield their assets from litigants using protections that are normally reserved for bankrupt companies. The goal of a Texas two-step is for the parent company to gain a third-party release of all liabilities it assigned to its spinoff, thus preventing litigants from pursuing those claims against the parent.

- Texas Divisive Merger:
  - Typically, a corporate merger involves two entities joining together so that the assets and liabilities of both become the assets and liabilities of the new, merged company. A Texas divisive merger achieves the opposite result: instead of two companies joining to become one, one company splits to become two. Corporate divisions or spin-offs are allowed in many jurisdictions, but the Texas divisive merger is distinctive because it treats the division as a merger. Notably, in a Texas two-step bankruptcy the parent company still maintains control over the spin-off by appointing its board and executive.
- For Today:
  - In a Texas Two Step bankruptcy, the spinoff is effected by a divisive merger under the TBOC (sometimes preceded by a Delaware corporation converting into a Texas corporation) and soon thereafter commences bankruptcy proceedings.

II. Texas Business Organization Code

- Overview:
  - Divisive mergers of corporations, LLCs and partnerships have been permitted under Texas law since 1989.
  - TBOC governs mergers, including divisive mergers, and applies to corporations, partnerships and LLCs. A divisive merger under the TBOC can include entities organized under the laws of another state so long as such state permits divisive mergers.
  - TBOC § 1.002(55): Defines "**merger**" to include "(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."