

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

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Byron F. Egan is a partner of *Jackson Walker LLP* in Dallas and is engaged in a corporate, partnership, securities, mergers and acquisitions (M&A) and financing practice, and his extensive experience in these matters. In addition to handling transactions, he advises boards of directors and their audit, compensation and special committees with respect to fiduciary duty and other corporate governance issues, special investigation and other issues.
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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.

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Outline

- I. Wikipedia
- II. Texas Business Organization Code (“*TBOC*”)
- III. Delaware Limited Liability Company (“*LLC*”) and Limited Partnership (“*LP*”) Division Statutes
- IV. Effect of Transaction
- V. Divisive Mergers and Creditors
- VI. Sample Texas Plan of Divisive Merger

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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.

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- **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.

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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.”

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