

Jones Day's \$100 Million Gain Through a Debated Bankruptcy Strategy: A Closer Look



Jones Day partner Gregory Gordon has created a legal strategy called the “Texas Two-Step,” which has been hailed as the “greatest innovation in the history of bankruptcy” by some but has come under criticism from others who view it as an abuse of the bankruptcy system. The strategy allows a solvent company to create an affiliate company that takes on the tort liabilities of the original company, thereby allowing the original company to file for Chapter 11 bankruptcy and avoid paying out potential billions in mass tort liabilities.

The Jones Day bankruptcy team has successfully used this strategy for four bankruptcies, including on behalf of Koch Industries’ Georgia Pacific in 2017, French manufacturing firm Saint-Gobain, Trane Technologies, and Johnson & Johnson. The firm has reportedly collected over \$107 million in Texas Two-Step fees as of February 2023.

While Jones Day has defended the strategy as expediting the payment process for plaintiffs-turned-creditors, attorneys on the plaintiff side have criticized it as an abuse of the bankruptcy system. The Third Circuit had halted the practice in the Johnson & Johnson talc litigation, citing the lack of finding that the parent company was in financial distress when it filed for bankruptcy.

The opinion of federal appellate Judge Thomas Ambro stated that “Good intentions—such as to protect the J&J brand or comprehensively resolve litigation—do not suffice alone. What counts to access the Bankruptcy Code’s safe harbor is to meet its intended purposes. Only a putative debtor in financial distress can do so. LTL was not.” The litigation in the Johnson & Johnson talc case has been moved from North Carolina to New Jersey, where the burden of proof now falls on the debtors to prove that they filed for bankruptcy in good faith.

While it remains to be seen if other jurisdictions will adopt the Third Circuit’s interpretation of the practice, the decision adds a new risk factor for companies interested in using the Texas Two-Step strategy. It is also worth noting that the controversy around this practice underscores the importance of lawyers who can think outside the box to net their clients’ advantages that may not be immediately apparent. It also highlights the ethical considerations that must be considered when developing and implementing such strategies.