Claim Durability and Bankruptcy's Tort Problem

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Bankruptcy has a tort problem. Chapter 11 predictably subordinates the claims of tort and other involuntary creditors to those of financial lenders, a fact which encourages firms to rely excessively on secured debt and discount the interests of those they might incidentally harm. For this reason, many scholars have advocated changing repayment priorities to move tort creditors to the front of the line. But despite broad academic support for a new "super priority," the idea has yet to inspire legislative action.

This Article proposes an alternative solution rooted in tort claims' temporal durability. Chapter 11 subordinates tort claims only because of a convention that assets should emerge free-and-clear of prepetition debts if those who control the reorganization so elect. Bankruptcy courts could buck the convention and insist that tort claims follow a debtor's assets out of Chapter 11 unless a deal otherwise is struck. The theoretical insight motivating our proposal is that durability and priority are close substitutes. In broad strokes, a super-durability norm should produce similar effects to a super-priority rule. In some respects, using durability may in fact be superior. It could avoid the need for costly, inaccurate judicial efforts to estimate the extent of debtors' tort liability. It could also be implemented by judicial fiat and without new legislation. Whatever one thinks of implementation, taking claim durability seriously as a design variable raises questions—and extends recent debates—about when bankruptcy law needs to crystallize otherwise fluid legal relationships to achieve its ends.

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Introduction

Five months after the *New Yorker* surfaced allegations of sexual impropriety against Harvey Weinstein,[1] the famed producer's firm, the Weinstein Company, filed for bankruptcy.[2] New leadership was needed. A sale of the business as a going concern promised to best preserve its value.[3] But why route the transaction through bankruptcy? One does not generally invoke Chapter 11 to sell a business. State law usually suffices. The Weinstein Company, a Delaware LLC, could have been sold under the eye of the able Court of Chancery.[4] What the Company got from bankruptcy was neither especially sound execution nor especially prudent review. What it got was a way to transfer wealth from Mr. Weinstein's alleged victims, many of whom had colorable claims against the Company, to the Company's financial creditors.

1. Ronan Farrow, *From Aggressive Overtures to Sexual Assault: Harvey Weinstein's Accusers Tell Their Story*, NEW YORKER (Oct. 10, 2017), https://www.newyorker.com/news/news-desk/from-aggressive-overtures-to-sexual-assault-harvey-weinsteins-accusers-tell-their-stories [https://perma.cc/T64Y-DEKT].

2. Declaration of Robert Del Genio in Support of First Day Relief ¶ 46, *In re* Weinstein Co., No. 18-10601 (Bankr. D. Del. Mar. 20, 2018).

3. *Id.* ¶ 4 (explaining that the reason to file was "to permit an orderly sale of substantially all of the Debtors' assets . . . in order to maximize the value of the estate for the benefit of creditors and other stakeholders").

4. Indeed, the Company seems to have been lining up a sale *outside* bankruptcy until the putative buyer reneged at the last minute. *Id.* ¶¶ 50-63.

If the Weinstein Company had been sold outside bankruptcy, the women might have sought damages from the buyer, as successor-in-interest.[5] The Company used Chapter 11 to rule out that possibility.[6] It was not a novel tactic. Bankruptcy is often used to extinguish claims that might otherwise follow a distressed business.[7] Buyers will offer a premium for immunity. Presumably the Company fetched more in Chapter 11 than it would have had it been sold in the ordinary course. Because sale proceeds are applied first to satisfy senior creditors, the predictable effect of using bankruptcy was to increase the secured lenders' recoveries at the tort plaintiffs' expense.[8]

The dynamic underlying the Weinstein Company case is an example of bankruptcy's tort problem.[9] As it is practiced, Chapter 11 subordinates tort and other involuntary creditors, who often receive token recoveries no matter how objectionable the conduct giving rise to their claims may be.

The ability to shed tort and environmental obligations in bankruptcy creates a judgment-proof problem.[10] In a world of limited liability for shareholders and priority for secured creditors, tort victims bear insolvency risk. They must bear the costs of injury if the tortfeasor's assets are insufficient. Yet they are not paid for doing so. Business managers therefore face an asymmetry in the way investors—broadly understood to include *involuntary* investors—respond to balance-sheet risk. Financial lenders charge less interest if they will be repaid first, but involuntary creditors cannot charge more for being made to rank last. To exploit the asymmetry,

5. *See infra* notes 72-77 and accompanying text. *See generally, e.g.*, Complaint, Geiss v. Weinstein Co., No. 1:17-cv-9554, 2017 WL 6034904 (S.D.N.Y. Dec. 6, 2017).

6. The plaintiffs must decide whether to accept a total of $17 million to be funded primarily by the Company's insurers. Jonathan Randles, *Harvey Weinstein's Victims Should Vote on Settlement Offer, Judge Says*, WALL ST. J. (Oct. 20, 2020), https://www.wsj.com/articles/harvey-weinsteins-victims-should-vote-on-settlement-offer-judge-says-11603227477 [https://perma.cc/C7ET-GBW3].

7. Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 732-39 (2019). Another reason debtors with substantial tort obligations file for bankruptcy protection is to release third parties of liability. For background, see Comm'n to Study the Reform of Chapter 11, *Final Report and Recommendations*, AM. BANKR. INST. 253-55 (2014). For a critical discussion, see Lindsey D. Simon, Bankruptcy Grifters (2020) (unpublished manuscript) (on file with authors).

8. The bankruptcy judge approved a sale of the business to Lantern Capital for $289 million. Order, *In re* Weinstein Co., No. 18-10601 (Bankr. D. Del. May 9, 2018); *see* Gene Maddaus, *Weinstein Co. Closes $289 Million Sale to Lantern Capital*, VARIETY (July 16, 2018), https://variety.com/2018/biz/news/weinstein-co-closes-1202873818 [https://perma.cc/8SWN-232U].

9. We use "tort" expansively to include debts not established under a contractual or otherwise reciprocal framework. Thus, we include, for example, environmental and regulatory debts. *Cf.* Sarah E. Light, *The Law of the Corporation as Environmental Law*, 71 STAN. L. REV. 137, 199-200 (2019) (describing prospect of free-and-clear disposition as a disincentive to comply with environmental laws).

10. S. Shavell, *The Judgment Proof Problem*, 6 INT'L REV. L. & ECON. 45, 45 (1986).

profit-maximizing companies will tend to employ excessive leverage and discount the harms they may inflict on others.[11]

Bankruptcy's tort problem has taken on new urgency in recent years. It first emerged as a challenge in the 1980s with the asbestos cases. The toxin's ubiquity and long latency period between exposure and serious illness posed conceptual as well as institutional challenges for reorganization practice.[12] Recently, however, the treatment of tort and other involuntary claims has emerged as *the* key theme of bankruptcies spanning a wide range of industries and sources of obligation—from responsibility for coal cleanup[13] and wildfire deaths[14] to liability for opioid abuse,[15] child molestation,[16] and sexual assault.[17]

Scholars have long understood that bankruptcy can prevent companies from bearing many of the social costs of their behavior. Two remedial proposals have proved influential. One idea, most closely identified with Henry Hansmann and Reinier Kraakman,[18] is to abolish limited liability for corporate torts—to allow tort victims to recover from shareholders the balance of any judgment a primary corporate wrongdoer's assets prove

11. *See, e.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 867 (1996); *infra* Section I.A.1.

12. *See, e.g.*, Mark J. Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846, 847 (1984); Christopher M.E. Painter, Note, *Tort Creditor Priority in the Secured Credit System: Asbestos Times, the Worst of Times*, 36 STAN. L. REV. 1045, 1062 (1984). The "future claimant" problem pits those whose claims have matured at the time of a company's bankruptcy against those whose claims are contingent or unmatured. It implicates the interests of tort creditors (as a class) to the extent there is a lag between unlawful conduct and injury. But it is fundamentally a conflict between earlier-in-time and later-in-time creditors (all of whom *might* be tort creditors). Our interest in this Article is in conflict between higher- and lower-priority creditors, so we will not treat future claimant issues further. The curious reader should start with Mark J. Roe's article and Frederick Tung, *Taking Future Claims Seriously: Future Claims and Successor Liability in Bankruptcy*, 49 CASE W. L. REV. 435 (1999). Kenneth Ayotte and Yair Listokin should be consulted on trust design. *See* Kenneth Ayotte & Yair Listokin, *Optimal Trust Design in Mass Tort Bankruptcy*, 7 AM. L. & ECON. REV. 403 (2005); Yair Listokin & Kenneth Ayotte, *Protecting Future Claimants in Mass Tort Bankruptcies*, 98 NW. U. L. REV. 1435 (2004) [hereinafter Listokin & Ayotte, *Protecting Future Claimants*].

13. *See* Joshua C. Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879 (2019).

14. *See* Derek Hawkins, *PG&E Reaches $13.5 Billion Settlement with California Wildfire Victims*, WASH. POST (Dec. 6, 2019), https://www.washingtonpost.com/nation/2019/12/06/pge-reaches-billion-settlement-with-california-wildfire-victims [https://perma.cc/B9V3-LSW2].

15. *See* Gerald Posner & Ralph Brubaker, Opinion, *The Sacklers Could Get Away with It*, N.Y. TIMES (Jul. 22, 2020), https://www.nytimes.com/2020/07/22/opinion/sacklers-opioid-epidemic.html [https://perma.cc/7H6L-L4NR].

16. *See* Mike Baker, *At Stake in Boy Scouts' Bankruptcy: $1 Billion in Assets, or Much More*, N.Y. TIMES (Feb. 19, 2020), https://www.nytimes.com/2020/02/19/us/boy-scouts-bankruptcy-assets.html [https://perma.cc/7A9A-Z9UU]; *see also* Pamela Foohey, *Bankrupting the Faith*, 78 MO. L. REV. 719, 731-32 (2013) (reporting nineteen church bankruptcies stemming from sexual abuse claims between 2006-2011).

17. *See* Megan Twohey & Jodi Kantor, *Weinstein and His Accusers Reach Tentative $25 Million Deal*, N.Y. TIMES (Dec. 11, 2019), https://www.nytimes.com/2019/12/11/us/harvey-weinstein-settlement.html [https://perma.cc/EA8R-CBF6].

18. *See* Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991).

insufficient to pay.[19] The primary alternative, first developed by F.H. Buckley,[20] Kathryn Heidt,[21] and David Leebron,[22] is to establish a statutory super-priority for tort claims.[23] Both proposals can be shown to improve managers' incentives, at least in principle.[24] The super-priority's appeal in particular has become an article of faith among bankruptcy scholars with a wide range of perspectives.[25] Academic popularity has not, however, translated into legislative action.

This Article proposes and explores the merits of establishing what we call a *super-durability norm*. The idea is to insist that tort claims follow a debtor's assets through and beyond Chapter 11, attaching to the reorganized debtor or, in case of a going-concern sale, to the buyer. Tort creditors would in effect choose whether to litigate against the post-bankruptcy company or accept what those in control of the Chapter 11 process offer to resolve the claims. The advantage of super-durability over the status quo inheres in the bargaining parameters it would underwrite. In brief, the parties' estimates of the magnitude of liability could be expected to ground settlement discussions. Today, by contrast, the amount of liability is almost irrelevant in many cases. A debtor's insurance coverage rather than its fault determines what tort creditors can hope to recover.

The central motivating insight is that durability and priority are close substitutes. At first approximation, a super-durability norm would improve incentives the same way as a super-priority rule. It would increase tort creditors' recoveries at the expense of financial lenders' recoveries. Lenders would thus have to recalibrate. They would have to increase interest rates or mandate more insurance for leveraged borrowers. They would have reason to insist on, and borrowers would have reason to agree to, cost-effective prophylactic measures. Despite such measures, however, risky businesses would see their capital costs grow and their footprints shrink. In short, they would better internalize the costs of the risks they impose if tort claims enjoyed either greater priority or durability.

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19. *Id.* Mark Roe suggested a similar doctrinal innovation, for similar reasons, five years earlier in response to the asbestos bankruptcies. *See* Mark J. Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 40-42 (1986); *cf.* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 51 U. CHI. L. REV. 89, 107 (1985) (arguing that "the magnitude" of limited liability's tort problem "is reduced by corporations' incentives to insure").

20. F.H. Buckley, *The Bankruptcy Priority Puzzle*, 72 VA. L. REV. 1393 (1986).

21. Kathryn R. Heidt, *Cleaning up Your Act: Efficiency Considerations in the Battle for the Debtor's Assets in Toxic Waste Bankruptcies*, 40 RUTGERS L. REV. 819 (1988) (focusing on environmental claims).

22. David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565 (1991).

23. The first suggestion of a super-priority rule seems to have been in a student note in the *Stanford Law Review*. *See* Painter, *supra* note 12, at 1080-81.

24. *See infra* Section I.B.

25. *See infra* Section I.B.2.

Nevertheless, a super-durability norm might in fact be superior to a super-priority rule. For one thing, it does not require costly and inaccurate estimation procedures. A super-priority rule depends on just that. It calls on the bankruptcy judge to reduce to a point estimate her intuitions about how underlying causes of action would fare in a counterfactual world where they were prosecuted in state court. Valuation is, of course, a staple of bankruptcy practice. But it is not an especially reliable or attractive part of the practice.[26] A super-priority rule would expand its domain to a realm where even the limited discipline of discounted cash-flow analysis is absent. Tort verdicts are notoriously uncertain. Lenders would be motivated to influence the judicial assessment. Whether dispersed, involuntary claimants would adequately protect their collective interests is an open question.[27] In any event, the process would be expensive. Under a super-durability norm, by contrast, valuation would be left to the parties. If no deal were reached, the default would not be a hearing; the tort claimants would simply wait for the firm to emerge from bankruptcy and bring suit against the successor entity.[28] A durability norm could thus encourage bargaining over litigation.

Moreover, a super-durability norm would not face the political-economy barriers that have frustrated super-priority proposals. The features of Chapter 11 that extinguish tort claims depend on judicial approval. Judicial *dis*approval could be the beginning of a super-durability norm. The buck could start with the bench even absent legislative action.

To be sure, judicial implementation of a super-durability norm would face its own hurdles. In a world of liberal forum-selection rules, the norm could be expected to have real bite in large cases only if its wisdom were widely recognized. Judicial implementation would also require upsetting established patterns of practice. In the modern era, bankruptcy judges have been generally willing to extinguish claims at the behest of a sale or plan proponent.[29] Their deferential attitude is consistent with the dictum that bankruptcy officials ought to do what they can to "maximize the value of

26. For discussions of costs entailed by and sources of inaccuracy and imprecision in bankruptcy valuation, see Kenneth Ayotte, *Disagreement and Capital Structure Complexity*, 49 J. LEGAL STUD. 1 (2020); Kenneth Ayotte & Edward R. Morrison, *Valuation Disputes in Corporate Bankruptcy*, 166 U. PA. L. REV. 1819 (2018); and Anthony J. Casey & Julia Simon-Kerr, *A Simple Theory of Complex Valuation*, 113 MICH. L. REV. 1175, 1188-89 (2015).

27. An adequately funded statutory representative of tort claimants could mitigate their collective-action and liquidity problems.

28. In cases where the tort creditors themselves face a holdout problem, a committee or voting process could be used, either in an advisory or binding manner.

29. Reorganized firms frequently assume some prepetition obligations voluntarily. *See* Mark J. Roe & Joo-Hee Chung, *How the Chrysler Reorganization Differed from Prior Practice*, 5 J. LEGAL ANALYSIS 399, 416-26 (2013) (tabulating data from large-corporate bankruptcies resolved through section 363 sale). But they do so to maintain a relationship with an important counterparty or to buy labor peace. Tort claims are not usually among the obligations voluntarily assumed, because most businesses have no relationship-specific investment in their tort creditors.

the estate."[30] Super-durability works precisely because it does *not* maximize the estate's saleable value. Its logic thus implies a qualification to prevailing ideas. If bankruptcy aims to put resources to their highest-value use, asset-value, not estate-value, should guide discretion.[31]

One has to be careful, though, not to overstate the novelty of the judicial attitude we propose. The attitude is in fact deeply rooted in reorganization law. As far back as the railroad equity receiverships, courts have been willing to recognize extraordinary claim durability to ensure that disfavored creditors receive fair treatment. Indeed, the upshot of the most famous of all the receivership cases, *Northern Pacific Railway v. Boyd*, was that an empty-handed tort creditor could assert the full amount of his claim against a reorganized company notwithstanding the fact of an intervening foreclosure sale.[32] *Boyd* featured a creditor whom the reorganization had completely shut out even as it distributed value to shareholders, treatment the absolute priority rule today would prevent.[33] Nevertheless, the case—and its forebears—can be read broadly to condone super-durability as a judicial strategy for ensuring a claim's fair treatment.[34]

The prospect of a durability norm for tort claims has implications for bankruptcy theory whatever one ultimately makes of the idea. In recent years, prominent scholars have joined a debate on the wisdom of the absolute priority rule.[35] Critics of the rule object to the assumption embedded in it that bankruptcy must collapse future possibilities to achieve its ends. Bankruptcy can be imagined as a sieve. The critics reason that junior investors' optionality can pass through the sieve without threatening any of reorganization law's cardinal functions. This Article is, among other things, a provocation to widen the terms of debate. Our narrow thesis is that law

30. *See, e.g.*, *In re* Pursuit Capital Mgmt., LLC, 595 B.R. 631, 659 (Bankr. D. Del. 2018) (declaring one of two "primary goals" of the Bankruptcy Code "to maximize the value of the estate for the benefit of creditors").

31. Vincent S.J. Buccola, *The Bankruptcy Firm*, 167 U. PA. L. REV. ONLINE 1, 5-8 (2019). Bankruptcy officials should also consider the perverse incentives a strict value-maximization norm generates.

32. 228 U.S. 482, 502 (1913); *cf.* R.R. Co. v. Howard, 74 U.S. (7 Wall.) 392 (1869) (holding that beneficiaries of a railroad's guarantees could assert claims against purchasers of the railroad's assets at foreclosure sale).

33. 11 U.S.C. § 1129(b)(2)(B)(ii) (2018).

34. *See* Douglas G. Baird, *The Unwritten Law of Corporate Reorganizations*, 36 EMORY BANKR. DEV. J. 699, 709-10 (2020).

35. Important contributions include Barry E. Adler & George Triantis, *Debt Priority and Options in Bankruptcy: A Policy Intervention*, 91 AM. BANKR. L.J. 563 (2017); Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930 (2006); Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759 (2011); Anthony J. Casey & Joshua C. Macey, *The Hertz Maneuver (and the Limits of Bankruptcy Law)*, U. CHI. L. REV. ONLINE *1 (2020); Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862 (2014); Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. PA. L. REV. 785 (2017); and Jonathan M. Seymour & Steven L. Schwarcz, *Corporate Restructuring Under Absolute and Relative Priority Default Rules: A Comparative Assessment*, 2021 U. ILL. L. REV. 1.

might work better if tort claims can flow through the bankruptcy sieve. More broadly, though, we hope to show by illustration that the absolute priority rule is but one example of Chapter 11's general tendency to truncate open-ended legal relationships.[36] The general question—which in our view has yet to receive a satisfactory *general* answer—is which legal relationships ought to flow through the bankruptcy sieve and which, by contrast, the law must crystallize and resolve.

The Article proceeds in four Parts. Part I lays the foundation. It explains the problem and reviews the relevant academic literature. Part II sets out our proposal. It outlines two mechanisms by which bankruptcy judges could promote super-durability within the confines of existing law. Part III assesses the significance of a super-durability norm. It shows that in many cases, such a norm would force debtors and creditors to internalize some of the social costs of business and facilitate bargaining between tort claimants and other creditors. It then discusses more complex scenarios—in particular, where there is contingent or otherwise unknown liability, asymmetric information about the nature of liability, or what we call *hot potato* assets. Part IV addresses the chief practical objections to our proposal: counter-strategies managers and financial creditors might adopt to frustrate our proposal. We conclude that a presumption in favor of super-durability would do much to solve bankruptcy's tort problem.

I. Bankruptcy's Tort Problems

The bankruptcy process systematically undercompensates tort creditors. By definition, a company's insolvency implies that not everyone can be repaid in full. However, not only do tort creditors typically recover less than one hundred cents on the dollar, but they recover less relative to other claimants than they ought to. We are by no means the first to say so. The predominant academic view holds, in response, that tort claims should have first dibs on a bankrupt debtor's resources.[37] Parts II and III outline and assess ways to implement a similar norm without congressional action. First, we set the stage with an account of the problem—its legal source and economic significance—and sketch the two leading, but seemingly infeasible, proposals to curb it.

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36. Anthony Casey and Edward Morrison recently made just this point in another context. *See* Anthony J. Casey & Edward R. Morrison, *Beyond Options*, *in* RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW 193 (Barry E. Adler ed., 2020) (examining truncation of senior creditors' real option to foreclose).

37. *See infra* Section I.B.2.

A. The Culprits

A common theme in corporate bankruptcies is that tort creditors fare poorly. Pennies on the dollar is standard compensation for prepetition injury.[38] The Weinstein Company case described above is a telling example but by no means unique. Black-letter doctrine and the bargaining dynamics of Chapter 11 ensure that tort creditors end up on the bottom of the heap.

Two features of the legal landscape—shareholder limited liability and the priority of secured debt—are the primary culprits. Limited liability sets an upward limit on the recovery available to all creditors at the value of the debtor's assets. In doing so, it prevents tort creditors from recovering from the debtor's shareholders.[39] The priority of secured debt means that creditors with a lien on an insolvent corporation's property are entitled to the value of the encumbered property (up to the amount of the claim). Together, the doctrine of limited liability and the priority afforded to secured creditors ensure that a bankrupt firm's tort creditors' compensation generally comes from whatever value remains after secured claims have been paid. Modern capital structures are often designed so there is little, if any, residual value left for tort creditors.[40]

Tort creditors' weak bargaining position also reduces the amount that they are able to recover from bankruptcy. In theory, unsecured creditors should share roughly pro rata in the residual value after secured claims are paid.[41] In practice, however, tort claimants often fare worse than other unsecured creditors because, almost by definition, they have nothing to offer a reorganizing enterprise. Other unsecured creditors, such as vendors, customers, and employees, may continue to interact with the business.

38. Sometimes debtors, especially small businesses, file with (because of) a recent tort judgment. *See List of Asbestos Bankruptcies*, CROWELL MORING (2020), https://www.crowell.com/files/list-of-asbestos-bankruptcy-cases-chronological-order.pdf [https://perma.cc/WL4V-YA6Q] (listing all bankruptcies triggered by asbestos litigation). In many such cases we know the debtor's tort liability. But in other cases, a debtor files before the claims are reduced to judgment. The liability *can* be estimated as part of the bankruptcy process, but it need not be if the plan of reorganization is consensual. *See* Kavya Balaraman, *Judge Approves PG&E Wildfire Settlements, Bringing Utility Closer to Exiting Bankruptcy*, UTIL. DIVE (Dec. 18, 2019), https://www.utilitydive.com/news/bankruptcy-judge-approves-pge-wildfire-settlements-utility-reorganization/569304 [https://perma.cc/CWA8-UXWH].

39. Veil piercing theory defines a gracious limit to limited liability. *See* Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 104-10 (2014).

40. *See* Vince Sullivan, *Murray Energy Lenders Sue to Undo Prepetition Refinancing*, LAW360 (Nov. 20, 2019), https://www.law360.com/articles/1221989/murray-energy-lenders-sue-to-undo-prepetition-refinancing [https://perma.cc/PE2C-NEM8] (describing how Murray Energy refinanced its debt shortly before filing for bankruptcy so that financial creditors would be paid before tort and environmental claimants).

41. *See* David A. Skeel, Jr., *The Empty Idea of "Equality of Creditors,"* 166 U. PA. L. REV. 699, 700 (2018).

Debtors often find ways to pay these claims in full.[42] Not so with tort creditors, whose claims are pure *legacy* liabilities and are treated as such. Their leverage, the right to block a plan of reorganization that "discriminate[s] unfairly" against them,[43] is worth little in practice. Debtors take advantage of a variety of means to distribute value to the unsecured creditors they like best long before a plan of reorganization comes into view.[44]

Moreover, investors' expectations about how bankruptcy might affect competing claims informs capital-structure and investment decisions to the detriment of tort claimants. These decisions in turn increase the likelihood that a company will injure third parties and reduce the size of those victims' recoveries.[45] The basic problem—the reason we say tort creditors are undercompensated—is that existing norms encourage the managers of, and investors in, leveraged companies to discount excessively the risks their businesses pose and to maintain potentially inefficient capital structures precisely in order to push risk onto third parties.

To illustrate, consider the following hypothetical in a simple decision-making environment (featuring risk-neutral agents with complete information). Acme Corporation's CEO, faithful to her shareholders, must decide whether to create a new subsidiary to undertake a risky project. There are two relevant periods. In period 1, the CEO will decide whether to invest in the project, which will cost $10,000 cash. In period 2, the project—if the subsidiary invests—will either succeed or fail. If the project succeeds, it will yield an asset worth $14,000. If the project fails, it will yield an asset worth $10,000, but will also cause the company negligently to injure strangers to the tune of $4000.

The social decision rule is straightforward. Success generates a net return of $4000; failure generates a net social cost of the same amount. Acme should invest in the project if and only if it has at least an even-odds chance of success. But limited liability and the priority of secured debt encourage the CEO to underweight the expected cost of failure, to impose more risk than is socially warranted. (For simplicity, we will leave it to the reader to model the impact of the bankruptcy bargaining dynamics described above.)

42. One reason debtors may try to pay certain unsecured creditors is that doing so can help preserve value. For example, a clothing manufacturer that purchases fabric on favorable terms from a fabric provider may want to continue paying the fabric manufacturer in order to avoid defaulting on the contract. *See* Vincent S.J. Buccola, *The Janus Faces of Reorganization Law*, 44 J. CORP. L. 1 (2018).

43. 11 U.S.C. § 1129(b)(1) (2018).

44. *See, e.g.*, Skeel, *supra* note 41, at 714-20 (documenting the most common methods of subordinating disfavored unsecured creditors).

45. *See* Michael Ohlrogge, Insolvency and Incentives for Efficient Care (Mar. 1, 2018) (unpublished manuscript), https://ssrn.com/abstract=3136775 [https://perma.cc/K8F6-QME8] (finding that, as firms approach insolvency, they become more likely to violate environmental laws).

1. Perverse Effects of Limited Liability

Consider first the CEO's incentives if the project is to be financed entirely with Acme's equity capital (scenario 1). If the project succeeds, Acme, the subsidiary's sole shareholder, nets $4000. It captures the full social benefit of the venture. If the project fails, Acme suffers the full social cost: the tort victims are made whole from the value of the subsidiary's asset, leaving Acme with $6000 of value, for a loss of $4000.

Scenario 1

Assumptions: (1) 100% equity financing, (2) limited liability & (3) p = probability of success

	Value in Success	***Value in Failure***	***Expected Value***
Tort Victims	0	4000 – 4000 = 0	0
Equity	14,000 – 10,000 = 4000	6000 – 10,000 = -4000	$(p)(4000) + (1-p)(-4000)$
Total Social Value	***4000***	***-4000***	***(p)(4000) + (1–p)(-4000)***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-2 (50%)

On these facts, Acme fully internalizes the risk the project imposes on strangers. The CEO makes the socially optimal choice, undertaking the project only if probability-weighted social benefits of success are more than harms of failure.

The socially optimal result will not always hold, however. Suppose, for example, the same facts except that the project will yield a $30,000 asset if it succeeds and yield a $10,000 asset, but impose $20,000 of tort damages, if it fails (scenario 1a). The social benefits of success are still identical to the social harms of failure. A socially motivated executive would invest only if success were at least as likely as failure. But the CEO faithful to her shareholders' pecuniary interests would think differently. If the project succeeded, Acme would reap the full $20,000 of benefit. If it failed, its loss would be capped at $10,000, the amount of invested capital. Acme would "externalize" the other $10,000 of social loss. A CEO seeking to maximize shareholder value would thus invest in the project if it had as little as a 1-in-3 chance of success.

The general rule is that shareholders of a company that finances its operations entirely with equity will underweight the costs their business imposes on strangers to the extent those costs might exceed the value of the company's assets.[46] Nevertheless, in an all-equity financing structure, the interests of shareholders and strangers are reasonably aligned except in situations that might yield catastrophic mass liabilities.

2. Perverse Effects of Secured Debt Priority

Leveraged companies, especially those that rely heavily on secured debt, face more perverse incentives. To see this, consider a variation on the Acme hypothetical above. Suppose the company finds a lender that is willing to put up $9000 of the $10,000 needed to finance the project. In exchange, the subsidiary must give a security interest in all of its assets and promise to repay the principal when the project is completed (scenario 2). (It is a 0%-interest loan.)[47]

The payoffs in this scenario are as follows. If the project succeeds, the lender is paid in full ($9000) and the shareholders receive the residual $5000 of value on an investment of $1000. If the project fails, the picture is more complicated. The lender, having first priority in a bankruptcy, recovers its full $9000 claim. (The loan is risk-free.) This means the tort victims recover only a fraction of their claim. The subsidiary has only $1000 of value left to be claimed, and limited liability insulates the shareholders from having to make up the difference. The shareholders, for their part, lose their $1000 investment.

Scenario 2

Assumptions: (1) 90/10 debt/equity, (2) limited liability & (3) p = probability of success

	Value in Success	***Value in Failure***	***Expected Value***
Tort Victims	0	1000 – 4000 = -3000	(1–p)(-3000)
Lender	9000 – 9000 = 0	9000 – 9000 = 0	0
Equity	5000 – 1000 = 4000	0 – 1000 = -1000	(p)(4000) + (1–p)(-1000)
Total Social Value	***4000***	***-4000***	***(p)(4000) + (1–p)(-4000)***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-5 (20%)

The CEO's calculus includes only one-fourth of the effect of the project's failure on the tort victims. She cares only about the fact that the shareholders stand to gain $4000 in case of success and to lose $1000 in case

46. Roe, *supra* note 19. The asbestos cases of the 1980s revealed instances of this pattern. Some of the opioid cases seem to share it. Purdue, at least, seems to have carried very little if any funded debt.

47. We use a zero-interest loan to abstract from questions of capital cost and so make a comparison of nominal returns instructive. In reality, of course, the financing choice would be a function in part of the relative cost of equity and debt capital.

of failure. She thus will invest if the project has as little as a 1-in-5 chance of success.

The significance of secured debt under existing bankruptcy norms can be described in general terms: priority allows investors to externalize the risk that their business will create harms that exceed the difference between the value of the company's assets and the face amount of secured claims.[48] The ability to impose tortious harm can be understood as a special kind of capital; it is an input to production. But because the size of a tort judgment does not scale with the tortfeasor's credit risk, the *price* of tort to the company is invariant to a company's leverage. Two conclusions follow. Companies will tend to take on more leverage than is socially optimal,[49] and leveraged companies will tend to impose more tort risk than is socially optimal.[50]

B. Extant Proposed Responses

The academic literature first recognized bankruptcy's tort problem in the 1980s, during the wave of asbestos filings.[51] Since then, scholars have proposed two solutions. Each proposal targets one of the two issues (limited liability and a priority claim for secured creditors) we identified above. The proposals, especially proposals to grant tort creditors a super-priority claim, enjoy broad academic support. We think both proposals would improve on the status quo, though both have very real downsides. Unlimited liability for corporate torts might make it more difficult for firms to raise capital. A super-priority for tort claims might force involuntary creditors to engage in costly and speculative valuation disputes. Moreover, it is not clear that either proposal could be implemented. And that proviso is fatal. Both proposals would require implementing legislation unlikely to come from Congress or the state capitals.

1. Unlimited Shareholder Liability

One suggestion, most closely identified with Henry Hansmann and Reinier Kraakman, would make shareholders liable on an unlimited basis

48. *See, e.g.*, Buckley, *supra* note 20, at 1417; Leebron, *supra* note 22, at 1568; Painter, *supra* note 12, at 1057.

49. The first to observe this fact, as far as we are aware, is James H. Scott, Jr., *Bankruptcy, Secured Debt, and Optimal Capital Structure*, 32 J. FIN. 1, 2 (1977) ("By the issuance of secured debt, the firm can increase the value of its securities by reducing the amount available to pay legal damages in the event that the firm should go bankrupt.").

50. *See, e.g.*, Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. ILL. L. REV. 1, 32 ("To the extent that a firm knows that it will not have to fully compensate its future tort victims, it has too little incentive to take care to prevent accidents in the first instance.").

51. *See, e.g.*, Buckley, *supra* note 20; Heidt, *supra* note 21; Roe, *supra* note 12; Roe, *supra* note 19; Painter, *supra* note 12.

for a company's tort liabilities.[52] The logic of the proposal is straightforward. It would put shareholders as a group on the hook for a company's torts one way or another—either indirectly if the company pays (since the value of their shares will decrease by the amount of the payment), or directly if it does not. Under a rule of unlimited liability, the priority of secured debt is, at first approximation, irrelevant to tort creditors.[53]

To see this, return to the hypothetical in which Acme's leverage encouraged risk-taking, but now with a rule of unlimited shareholder liability (scenario 3). The way *Acme*'s value is distributed is identical to scenario 2. The lender is paid in full whether the project succeeds or fails. The shareholders take $5000 in case of success, but lose their $1000 investment in case of failure. And the strangers injured in case of failure recover only $1000 of their $4000 claim. The difference is that now the tort victims recover their $3000 deficiency claim from the shareholders in their individual capacities.

Scenario 3

Assumptions: (1) 90%/10% debt/equity, (2) *unlimited* liability & (3) p = probability of success

	Value in Success	***Value in Failure***	***Expected Value***
Tort Victims	0	(1000 + 3000) - 4000 = 0	0
Lender	9000 – 9000 = 0	9000 – 9000 = 0	0
Equity	5000 – 1000 = 4000	(0 – 1000) - 3000 = -4000	(p)(4000) + (1–p)(-4000)
Total Social Value	***4000***	***-4000***	***(p)(4000) + (1–p)(-4000)***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-2 (50%)

Shareholders reap the gains from success and bear the losses associated with failure. (The lender does not bear the losses associated with failure because the loan is risk-free.) Their payoffs reflect the social cost-benefit trade-off, and the faithful CEO therefore has an incentive to choose well.

In theory, unlimited shareholder liability could perfectly resolve bankruptcy's tort problem. In practice, however, the rule would cause some problems of its own. Among other things, unlimited liability discourages relatively wealthy investors, who anticipate being the primary targets of litigation, from owning shares alongside relatively judgment-proof

52. Hansmann & Kraakman, *supra* note 18. Mark Roe seems to have first suggested the idea in response to the asbestos bankruptcies. *See* Roe, *supra* note 19, at 40-42.

53. *See, e.g.*, Hansmann & Kraakman, *supra* note 18, at 1901-02; Leebron, *supra* note 22, at 1639.

investors.[54] It encourages wealthy shareholders to spend resources monitoring their fellows and to arrange their own affairs to become as judgment-proof as possible. Together these undermine the fungibility of shares, diminish the value of secondary markets, and so undermine to some extent the corporate form's utility in promoting capital formation.[55] Unlimited liability may also be difficult to implement. The administrative costs of filing suits against potentially thousands of shareholders in multiple venues would be enormous.[56] Legislation aimed at consolidation might drive investors offshore, making them effectively judgment proof.[57] These challenges are, of course, only special instances of the generic downsides of unlimited shareholder liability.[58]

Unlimited liability for corporate torts might yet on balance be good policy. Where share ownership is relatively concentrated—as, for example, in family- and private equity-owned companies—the advantages of limited liability are small and the costs of *un*limited liability therefore modest. Even where share ownership is relatively diffuse, companies could dampen the rule's side effects by keeping sufficient cash on hand or maintaining sufficient insurance to pay anticipated tort claims without opening recourse to shareholders.

But the question is moot. Such a radical change would require major legislative upheaval, probably on a state-by-state basis.[59] It is unlikely to come soon.[60]

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54. *See* Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967).

55. *See* Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117 (1980).

56. *See* Janet Cooper Alexander, *Unlimited Shareholder Liability Through a Procedural Lens*, 106 HARV. L. REV. 387, 418 (1992).

57. *See* Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 497 (2001); Joseph A. Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 YALE L.J. 387, 396 (1992).

58. *See* Easterbrook & Fischel, *supra* note 19, at 93-97.

59. The rule of limited liability is usually thought to be part of a corporation's internal affairs. Its reach therefore has traditionally been a matter of the chartering state's law. *See* Gregory Scott Crespi, *Choice of Law in Veil-Piercing Litigation: Why Courts Should Discard the Internal Affairs Rule and Embrace General Choice-of-Law Principles*, 64 N.Y.U. ANN. SURV. AM. L. 85 (2008). Presumably Congress could legislate on the topic. Vincent S.J. Buccola, *Opportunism and Internal Affairs*, 93 TUL. L. REV. 339, 346-48 (2018). Perhaps states could, too, with respect to torts committed in their respective territories. But legislation other than from chartering states would at least upend tradition.

60. If a state did abolish limited liability with respect to tort claimants, one would expect firms to reincorporate in states whose liability regimes were more favorable to equity. This "race to the bottom" would likely deter states from adopting such a radical reform unilaterally. *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974) (arguing that there is a race to the bottom among state incorporation laws); *cf.* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 271 (1977) (arguing that there is a race to the top); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 21 (1993) (describing specific instances in which competition among states has led to a race to the bottom and instances in which it has led to a race to the top);

2. Super-Priority for Tort Creditors

An alternative remedy for bankruptcy's tort problem would grant tort and other involuntary creditors a super-priority lien on debtor assets.[61] The idea is to expose involuntary creditors, who are not paid for taking on credit risk, to as little of it as possible. As with unlimited liability, the rule would make tort creditors indifferent to a company's leverage. Secured credit could not be used to externalize tort risk.

To see this, return to the Acme hypothetical, now with limited liability and a rule that requires that tort creditors be paid first from a debtor's assets (scenario 4). If the project succeeds, then, as before, the lender is repaid $9000 and the shareholders receive $5000. If the project fails, however, the tort creditors now recover their full damages ($4000). The lender takes the remaining $6000 of value. As in the previous example, the shareholders recover nothing.

Scenario 4

Assumptions: (1) 90%/10% debt/equity, (2) limited liability, (3) super-priority & (4) p = probability of success

	Value in Success	***Value in Failure***	***Expected Value***
Tort Victims	0	4000 – 4000 = 0	0
Lender	9000 – 9000 = 0	6000 – 9000 = -3000	(1–p)(-3000)
Equity	5000 – 1000 = 4000	0 – 1000 = -1000	(p)(4000) + (1–p)(-1000)
Total Social Value	***4000***	***-4000***	***(p)(4000) + (1–p)(-4000)***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-5 (20%)

Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992) (same).

61. The idea for a statutory super-priority originated in a student note. *See* Painter, *supra* note 12, at 1080-81. A number of articles developed the idea in the 1980s and early 1990s, and its superiority to the status quo became a common view among bankruptcy scholars. *See, e.g.*, Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 340 (1993) ("Ideally, nonconsensual claimants would have highest priority in any sort of firm."); Barry E. Adler, *A World Without Debt*, 72 Wash. U. L.Q. 811, 826 (1994); Douglas G. Baird, *Lessons from the Automobile Reorganizations*, 4 J. LEGAL ANALYSIS 271, 275 (2012); Bebchuk & Fried, *supra* note 11; Buckley, *supra* note 20, at 1417; Hanoch Dagan, *Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred*, 78 AM. BANKR. L.J. 247, 277 (2004); Heidt, *supra* note 21, at 839-41 (focusing on environmental claims); Leebron, *supra* note 22, at 1569 ("[T]ort claimants should be given priority in bankruptcy proceedings."); Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 61-63 (1996); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1891 (1994) ("[T]he appropriate remedy is to give involuntary creditors priority over secured creditors."); Rasmussen, *supra* note 50, at 32-33; Mark J. Roe, *Commentary on "On the Nature of Bankruptcy": Bankruptcy, Priority, and Economics*, 75 VA. L. REV. 219, 227 (1989) ("A rule of priority for nonbargain creditors seems efficient."); Note, *Switching Priorities: Elevating the Status of Tort Claims in Bankruptcy in Pursuit of Optimal Deterrence*, 116 HARV. L. REV. 2541, 2562 (2003).

The distinctive feature of this scenario is that the lender bears some of the business's tort risk. On the simplifying assumptions we have made—that the lender charges no interest and does not intervene in governance—Acme's shareholders are still able to externalize the risk, now onto the lender instead of the victims. But proponents of a super-priority for tort creditors reason that it would provoke a dynamic response from financial creditors. The lender would not offer the same loan terms in a world where it knows it might not recover as much as it would in a world in which it is protected from tort risk, as it is in the scenario posited above.

Formerly high-priority creditors could be expected to respond in two ways: price and governance. Start with price. Because secured creditors face increased credit risk under a super-priority regime, they will charge more interest. In our hypothetical, the lender loses $3000 if the project fails. Suppose the lender believed the project had a fifty percent chance of success. It would need to make $3000—or charge 33% interest—in order to hold constant its expected nominal return of $0 (scenario 4a). Acme's new interest expense in turn would drive down the profits available to shareholders if the project succeeds. Net of interest, the shareholders now would gain only $1000 in case of success. And, because they lose $1000 if the project fails, the lender's adjustment to the rule change forces the shareholders to internalize their business's tort risk.

Scenario 4a

Assumptions: (1) 90%/10% debt/equity, (2) risk-based debt pricing, (3) limited liability, (4) super-priority & (5) 50% probability of success

	Value in Success	*Value in Failure*	*Expected Value*
Tort Victims	0	4000 – 4000= 0	0
Lender	12,000 – 9000 = 3000	6000 – 9000 = -3000	3000/2 + -3000/2 = 0
Equity	2000 – 1000 = 1000	0 – 1000 = -1000	1000/2 + -1000/2 = 0
Total Social Value	***4000***	***-4000***	***4000/2 + -4000/2 = 0***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-2 (50%)

Secured lenders would also presumably respond to a super-priority rule by intervening more aggressively in the borrower's governance. In reality, unlike our hypothetical, the risks to which a lender will be exposed after funding are uncertain and prone to moral hazard. Borrowers therefore minimize the interest they must pay by inviting lenders to monitor, and in some instances veto, corporate activity, and also by bonding against excessive risk taking.[62] Under a super-priority norm, more of the costs of corporate torts would fall on financial creditors than they currently do. The

62. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 333-39 (1976).

optimal amount of monitoring and bonding, including the use of third-party insurance policies, would increase. Risk-taking, in turn, would decrease.[63]

Like the unlimited liability rule, a super-priority norm would solve bankruptcy's tort problem only imperfectly. For one thing, it would not force managers and financial investors to internalize the expected costs of very large accidents. With limited liability in place, tort creditors could only ever recover up to the entire value of the tortfeasor's assets. If the expected damages from a particular risk are very large relative to the value of a company's assets, then a rule effectively assigning the company to tort victims would still undercompensate tort victims and fail to efficiently deter corporate risk-taking.

While a super-priority norm would increase tort claimants' expected recoveries, it could also lead to complicated valuation disputes and might fail to provide adequate compensation for harms that have not fully manifested at the time of the bankruptcy. Frequently the magnitude of a company's tort and environmental liability is unknown when it files for bankruptcy. In some cases, including recently in PG&E and Purdue, companies file in large measure because they want a bankruptcy judge to sort out liability.

A super-priority rule might also provoke costly, strategic countermeasures. Managers and financial creditors of a company that faces large but unmatured tort liability might seek to wind down or otherwise alter the business's scope before bankruptcy, even if doing so were wasteful.[64] There is evidence, for example, that firms facing significant cleanup costs seek to separate valuable assets from environmental obligations. In doing so, they increase the likelihood that whoever takes over the valuable assets is able to do so without also assuming onerous cleanup costs.[65]

Despite its imperfection, we think that giving tort creditors a super-priority claim would be superior to the status quo.[66] The idea's biggest downside is the same as that of unlimited liability: it does not seem to be on the legislative agenda.

II. Implementing a Super-Durability Norm

We propose to ameliorate bankruptcy's tort problem by making tort claims durable to restructuring. More specifically, we encourage bankruptcy judges to extend a debtor's tort liability to the entity that holds the offending business's assets after the resolution of the bankruptcy. Under

63. Leebron, *supra* note 22, at 1565.

64. For a discussion, see *infra* Section IV.A.

65. See Macey & Salovaara, *supra* note 13, at 882-919. Note, though, that a durability rule would not fully resolve this problem. Stronger fraudulent conveyance law is needed to reduce strategic pre-bankruptcy asset partitioning. *See id.*

66. For further discussion, see *infra* Part IV.

this approach, tort victims not paid in full or otherwise satisfied with their treatment in bankruptcy would be able to assert their claims outside it.

We expect that a norm change along these lines would lead to better tort recoveries through Chapter 11 itself, as parties formulate plans in the shadow of each constituent's *outside option*. Part III will discuss the proposal's economic implications. Here our aim is just to unpack the mechanism by which bankruptcy judges could implement this proposal under current law. To that end, we first describe the non-bankruptcy "durability" baseline and the Chapter 11 status quo. We then address the mechanics of judicial implementation. As we explain, there are at least two practical versions of a super-durability norm, corresponding to less and more aggressive norm change.

A. Durability Doctrines Outside Bankruptcy

According to black-letter law, tort victims have only latent interests in a tortfeasor's assets. Like all unsecured creditors, their primary right is *personal*. It is a right that the debtor—and only the debtor—should pay its debts.[67] After a creditor reduces her claim to judgment, the state will assist her in seizing assets from a recalcitrant debtor.[68] But until then, her interest in the assets is fragile. It can be extinguished if the debtor transfers his property after becoming personally liable but before execution.[69] In general, an unsecured creditor can neither blame nor dispossess the transferee.

This orthodox statement of the implication of in personam liability obscures as much as it reveals, however. Where they apply, three exceptional doctrines allow an unsecured creditor to follow a debtor's property into a transferee's hands. These doctrines in effect make the creditor's interest durable to transfer. For present purposes, we can bracket judgment liens[70] and fraudulent transfer avoidance,[71] while simply noting their broad application and practical importance to law's remedial function.

Successor liability is the durability doctrine most pertinent for thinking about how above-board restructuring transactions treat tort creditors. The presumptive rule of corporate succession holds that a buyer that

67. *See generally* Joseph Henry Beale, *The Exercise of Jurisdiction* in Rem *to Compel Payment of a Debt*, 27 HARV. L. REV. 107, 111 (1913) (providing a taxonomy of in rem and in personam rights).

68. *See* David Gray Carlson & Paul M. Shupack, *Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part 1*, 5 CARDOZO L. REV. 287, 291-93 (1984).

69. This is not to say the unsecured creditor lacks any remedy during the interval. She may be able to attach assets to prevent their dissipation or get an injunction prohibiting transfer.

70. Every jurisdiction allows a judgment creditor to place a lien on at least some forms of debtor property. *See, e.g.*, 28 U.S.C. § 3201(a) (2018) (permitting judgment creditor to place a lien on the judgment debtor's real property).

71. Unsecured creditors can recover property a debtor has transferred, or its value, to the extent the transferee gave the debtor less than "reasonably equivalent value" for it. *See* UNIF. VOIDABLE TRANSACTIONS ACT §§ 4(a)(2), 5(a), 7(a) (UNIF. LAW COMM'N 2014).

purchases a company's assets at fair value is not responsible for the seller's debts.[72] The debt belongs to the debtor. Successor liability defines the circumstances in which the presumption gives way.[73] If the buyer voluntarily assumes the seller's debts, then of course it is liable.[74] Even absent voluntary assumption, the buyer can be held liable in most jurisdictions if a court finds that the buyer is a "mere continuation" of, or the result of a "de facto merger" with, the seller.[75]

The prospect of successor liability is relatively strong where the proceeds of a financially distressed company's sale yield tort creditors less than full recovery. This is not to say successor liability is ever a sure thing. The doctrine's vague predicates are a case study in the indeterminacy of transcendental nonsense.[76] Nevertheless, there are stronger and weaker cases. Vague as it is, the doctrinal language suggests common fact patterns. The paradigmatic going-concern transactions are designed either to *continue* the business in a new legal shell (with a healthier balance sheet and perhaps new owners) or to roll it up into an existing operation. Moreover, there is evidence that judges disproportionately find successor liability when failing to do so would yield less than full recovery for tort or other involuntary creditors.[77]

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72. The standard rule is that there is no liability for the buyer. *E.g.,* Aguas Lenders Recovery Grp. v. Suez, 585 F.3d 696 (2d Cir. 2009); Cargo Partner AG v. Albatrans, Inc., 352 F.3d 41 (2d Cir. 2003).

73. For discussion of successor liability's relationship to M&A activity, see Albert H. Choi, *Successor Liability and Asymmetric Information*, 9 AM. L. & ECON. REV. 408 (2007); Richard L. Cupp, Jr., *Redesigning Successor Liability*, 1999 U. ILL. L. REV. 845; Michael D. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17 (1986); John H. Matheson, *Successor Liability*, 96 MINN. L. REV. 371 (2011); and Mark J. Roe, *Mergers, Acquisitions, and Tort: A Comment on the Problem of Successor Corporation Liability*, 70 VA. L. REV. 1559 (1984).

74. *See Cargo Partner,* 352 F.3d at 45.

75. *See, e.g.*, David R. Kuney, *Successor Liability in Sales of a Debtor's Assets: The Problem of the "Mere Continuation" Exception*, 6 J. BANKR. L. & PRAC. 269, 270-71 & n.8 (1997) ("[U]nder existing law in most states, there is a serious risk that even bona fide, arm's length sales of assets to existing owners will result in liability for the successor entity, even in the face of explicit documentation to the contrary.").

76. *See* Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935).

77. *See* Frank Fagan, *From Policy Confusion to Doctrinal Clarity: Successor Liability from the Perspective of Big Data*, 9 VA. L. & BUS. REV. 391, 430 (2015) (analyzing factors that predict application of successor liability). There are good reasons for judges to focus the law this way. Absent successor liability, businesses expecting future tort judgments could sidestep liability by selling the business and paying the proceeds as a dividend to shareholders. Successor liability ensures that *some* pool of resources exists toward which tort claimants can look for satisfaction. *See, e.g.*, Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 983–85 (1971) ("In tort cases, on the other hand, there is usually no element of voluntary dealing, and the question is whether it is reasonable for businessmen to transfer a risk of loss or injury to members of the general public through the device of conducting business in the name of a corporation that may be marginally financed."); Roe, *supra* note 73, at 1562; *cf.* Bainbridge, *supra* note 57, at 513, 535 (noting that veil-piercing is "rare, unprincipled, and arbitrary," and stating that "[j]udicial opinions in this area tend to open with vague generalities and close with conclusory statements, with little or no concrete analysis in between"); Easterbrook & Fischel, *supra* note 19, at 89 ("'Piercing'

A consequence is that acquisitions made under ordinary state-law processes reflect investors' (probabilistic) expectations of tort liability. The more liability a buyer perceives to be associated with the seller's business, the less he will pay for it. The discount might not be dollar-for-dollar, of course. Victims could opt to recover from the seller's proceeds rather than from (or alongside) the buyer, or a court could decline to impose successor liability. The buyer is interested in what he expects to have to pay on account of the seller's liabilities.[78] But whatever the magnitude of the discount, its directional effect is predictable. Successor liability means that buyers will pay less for companies with existing or anticipated tort obligations.

B. Undoing Durability in Chapter 11

Chapter 11, as it is practiced today, allows debtors and their senior creditors to cut off successor liability.

Plans of reorganization. The conventional way to extinguish tort claims is through a plan of reorganization. When the Bankruptcy Code's framers placed the plan construct at the center of corporate reorganization, they hoped doing so would produce flexibility, allowing dealmakers to tailor a resolution to a debtor's unique circumstances.[79] In that spirit, the Code omits mandatory distributional norms. Any plan that meets minimal statutory requirements and garners supermajority support from every class of affected creditors can be confirmed.[80]

Distributional norms enter the picture through rules governing confirmation absent unanimity. If an impaired class objects, the plan cannot be confirmed unless it honors familiar hierarchical distribution norms.[81] In broad strokes these rules say that secured creditors must recover the full value of their collateral if the proposed plan would pay unsecured creditors anything; that certain classes of privileged unsecured creditors should be paid before unprivileged classes; that shareholders should recover nothing unless creditors are paid in full.[82] Consensual plans thus take the shape they do, more or less producing hierarchical *waterfall* recoveries, with a view to

seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled. There is a consensus that the whole area of limited liability, and conversely of piercing the corporate veil, is among the most confusing in corporate law.").

78. We invoke expectations here loosely. Risk-averse buyers of course care about variance as well as mean. For discussion of the effect of risk aversion on acquisition prices, see Choi, *supra* note 73; *see also infra* Section III.B.2.

79. *See, e.g.*, Mark J. Roe, *Three Ages of Bankruptcy*, 7 HARV. BUS. L. REV. 187, 192 (2017).

80. 11 U.S.C. §§ 1126, 1129(a) (2018). One exception: any lone creditor can object to the extent it recovers less under the plan that it would in a liquidation scenario. *Id.* § 1129(a)(7)(A)(ii).

81. *Id.* § 1129(b).

82. *Id.* § 1129(b)(2).

creditors' respective rights to object—with a view, that is, to objectors' *outside options*.

By default, confirmation of a plan extinguishes the ability of tort victims (and most other creditors) to recover outside the plan's terms—which, because they have general unsecured claims, are not often generous. The Code accomplishes this result in two steps: discharge and asset-cleansing. The section dealing with plan confirmation declares that—"[e]xcept as otherwise provided . . . in the plan, or in the order confirming the plan"—confirmation "discharges the debtor from any debt that arose before the date of such confirmation."[83] And it declares—again, "except as otherwise provided in the plan or in the order confirming the plan"—that "property dealt with by the plan is free and clear of all claims and interests of creditors."[84] In short, tort creditors take only what the plan gives them. They may not sue the reorganized debtor or follow its assets into the hands of another entity that might acquire the business under the plan.

Section 363 sales. An alternative way to extinguish tort claims is through an asset sale that receives the blessing of the bankruptcy judge. Section 363 of the Bankruptcy Code authorizes debtors, "after notice and a hearing," to "use, sell, or lease, other than in the ordinary course of business, property of the estate."[85] The provision was designed to allow a business in the process of reorganizing (read: shrinking) to shed productive assets, like equipment, it would no longer need, and to ensure the integrity of such a sale. Its language proved sufficiently broad, however, to justify a sea-change in Chapter 11 practice. In modern practice, section 363 is used to sell distressed businesses on a going-concern basis. Approximately one-third of all large-corporate debtors who file for Chapter 11 do so in order to sell the business.[86]

The most important, though not the only, reason managers of a distressed business might wish to sell in Chapter 11 is to cut off durability doctrines.[87] Section 363, unlike ordinary principles of state law, allows a

83. *Id.* § 1141(d).

84. *Id.* § 1141(c).

85. *Id.* § 363(b).

86. Katherine Waldock, A Typology of U.S. Corporate Bankruptcy (Dec. 31, 2019) (unpublished manuscript), https://www.aeaweb.org/conference/2020/preliminary/paper/ThzT9r5i [https://perma.cc/MM88-SCH6] (reporting the intentions of corporate filers, from 2004 to 2017, with at least $100 million in assets). Previous studies gauging the popularity of section 363 sales have estimated that anywhere from twenty percent to two-thirds of large-corporate cases result in a sale. *See* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 520-21 (2009); Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 675 (2003); Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 43-44 (2007); Stuart Gilson, Edith Hotchkiss & Matthew Osborn, Cashing Out: The Rise of M&A in Bankruptcy 39-40 tbl.1 (Mar. 6, 2016) (unpublished manuscript), https://ssrn.com/abstract=2547168 [https://perma.cc/232F-LJ5Y].

87. *See* Buccola, *supra* note 7, at 735-39. For an instructive discussion of bankruptcy law's ability to wash otherwise tainted assets transferred in a going-concern sale, see Michael H. Reed,

debtor to sell property "free and clear of any interest in such property."[88] The obvious application is to liens, which are traditionally described as "interests in property."[89] With the court's permission, a debtor can in effect solve a latent holdout dynamic among lienholders unlikely to recover in full on their claims. The Courts of Appeals most important for corporate bankruptcy practice have also, however, understood section 363 to permit sales that cut off successor liability.[90] That reasoning is suspect. Successor liability is not founded on an interest in property but is rather a theory of personal liability—a reason why one person ought to answer for another's wrongs.[91] But in any case, section 363 has evolved such that it now offers distressed companies a relatively cheap avenue to cut off tort liability and limit tort creditors to whatever is left of sale proceeds after senior creditors have been repaid.

In practice, section 363 sale orders routinely cut off the rights of tort creditors. Our analysis of section 363 sale orders issued by Delaware bankruptcy judges between 2014 and 2019 turned up no cases carving out tort claims from the free-and-clear disposition. Selling assets free-and-clear is consistent with the dictum to "maximize the value of the estate."[92]

Two exceptions to Chapter 11's tendency to undo durability are worth noting, both relating to liabilities "unknown" at the time of the bankruptcy. First, tort liabilities sufficiently remote at the time of disposition—whether by plan confirmation or sale—are not extinguished. The free-and-clear provisions work through the notion of a *claim*.[93] The word *claim* is a term of art in the Bankruptcy Code, one defined to invoke a broad but not unlimited notion of a "right to payment."[94] It includes even *contingent* rights. Yet in some instances where a debtor's prepetition (unlawful) conduct

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Successor Liability and Bankruptcy Sales, 51 BUS. LAW. 653 (1996); and Michael H. Reed, *Successor Liability and Bankruptcy Sales Revisited—A New Paradigm*, 61 BUS. LAW. 179 (2005).

88. 11 U.S.C. § 363(f) (2018).

89. *See, e.g.*, *Lien,* BLACK'S LAW DICTIONARY (8th ed. 2004).

90. Elliott v. General Motors LLC (*In re* Motors Liquidation Co.), 829 F.3d 135, 155-56 (2d Cir. 2016) ("[A] bankruptcy court may approve a § 363 sale "free and clear" of successor liability claims if those claims flow from the debtor's ownership of the sold assets."); *In re* Trans World Airlines, Inc., 322 F.3d 283, 288-90 (3d Cir. 2003); *see also* Ill. Dep't of Revenue v. Hanmi Bank, 895 F.3d 465, 472-75 (7th Cir. 2018) (holding that section 363 sale blocks tax collector's statutory right to follow assets in bulk sale transaction); *In re* Chrysler LLC, 576 F.3d 108, 123-26 (2d Cir. 2009), *vacated sub nom.,* Ind. State Police Pension Tr. v. Chrysler LLC, 558 U.S. 1087 (2010).

91. One can endorse the substantive rule while recognizing the statutory interpretation problem. The American Bankruptcy Institute's commission on Chapter 11 reform, for example, took the position that Congress should clarify the rule to resolve doubt. Comm'n to Study the Reform of Chapter 11, *supra* note 7, at 141-45.

92. *See, e.g.*, CFTC v. Weintraub, 471 U.S. 343, 352 (1985).

93. The discharge provision works through the notion of "debt." But a "debt" is just a liability on a claim. 11 U.S.C. § 101(12) (2018).

94. A "claim" includes any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *Id.* § 101(5)(A).

manifests injury only after disposition, courts say that no claim accrued before disposition and, consequently, that a plaintiff can assert its case without regard to the bankruptcy.[95] Second, a claimholder who receives insufficient notice of bankruptcy proceedings is not bound by a discharge.[96] Publication notice can suffice for creditors of whom a debtor is unaware.[97] Many tort victims may fit that description. But if a debtor fails to give personal notice when it could have identified claimants and given personal notice with relatively little effort, their claims will not be extinguished.[98]

The exceptions are, however, exceptional. As far as tort victims are concerned, the main tendency of Chapter 11 is to shorten the temporal horizon or recourse.

C. Proposal: Redoing Durability

We propose that bankruptcy judges should embrace successor liability by preserving or even strengthening the norm that tort claims follow a business.

The mechanism we have in mind is simple, although, as we will explain, it could be implemented in a couple of ways. The free-and-clear disposition of a debtor's assets requires judicial buy-in. Section 363 sales are conditioned on judicial approval after "notice and a hearing."[99] Property dealt with in a plan of reorganization passes free and clear only if neither the plan nor the confirmation order says otherwise.[100] These rules vest bankruptcy judges with enormous discretion, though the Code does not say how they should exercise that discretion.[101] It does not enumerate, much less exhaust, the facts that a bankruptcy judge should consider when authorizing a free-and-clear sale. Our suggestion is that they consider, and

95. *See In re* Chateaugay Corp., 944 F.2d 997 (2d Cir. 1991); *see also, e.g.*, Epstein v. Official Comm. of Unsecured Creditors (*In re* Piper Aircraft, Corp.), 58 F.3d 1573 (11th Cir. 1995) (successor liability can be discharged if prepetition conduct created a relationship between debtor and future claimant and liability arose from prepetition operations); Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159 (7th Cir. 1994) (no enjoining suit can be brought against the buyer of debtor assets free-and-clear); Olson v. Frederico (*In re* Grumman Olson Indus., Inc.), 445 B.R. 243 (Bankr. S.D.N.Y. 2011) (no extinction of successor liability in section 363 sale where injury occurred after sale and plaintiffs had no pre-sale relationship with debtor).

96. *See, e.g.*, Chemetron Corp. v. Jones, 72 F.3d 341, 346 (3d Cir. 1995) ("Inadequate notice is a defect which precludes discharge of a claim in bankruptcy.").

97. Tulsa Prof'l Collection Servs., Inc. v. Pope, 485 U.S. 478 (1988); Dahlin v. Lyondell Chem. Co., 881 F.3d 599, 603 (8th Cir. 2018).

98. The General Motors bankruptcy involved a prominent argument on this score. The Second Circuit held that Old GM had given insufficient notice to people harmed by its ignition-switch defect, such that they could seek to establish successor liability against New GM. Elliott v. General Motors LLC (*In re* Motors Liquidation Co.), 829 F.3d 135 (2d. Cir. 2016).

99. 11 U.S.C. § 363(b) (2018).

100. *Id.* § 1141(c).

101. *Cf.* Baird, *supra* note 34, at 710-16 (characterizing reorganization law as essentially open-ended judicial power to ensure that those who control a reorganization treat all claimants fairly).

give weight to, a proposed sale or confirmation order's treatment of tort claims.

Before explaining our proposal, we should answer what might be a temperamental reaction. To lawyers accustomed to the status quo, our proposal might sound outrageous, even unprecedented. Its very design aims to undermine lawful priorities, they might think, recalibrating debtors' capital structures on an ad hoc basis and moving unsecured creditors to the front of the line.

In a sense the charge is accurate. The aim is to produce better outcomes for tort creditors than they get under prevailing norms. And we do anticipate case-specific application of general principles.

But that is as far as the criticism holds up. There is no generic priority scheme to summon for defense, no Platonic pecking order subsisting beyond the concrete rules and norms of the bankruptcy forum (subject to constitutional limitations, of course).[102] The absolute priority rule—an important feature of Chapter 11, to be sure—says nothing about whom creditors can sue beyond the confines of bankruptcy. It governs only the distributions a contested plan or reorganization can make.[103] Absolute priority and the hierarchy it presupposes are useful heuristics, but they no longer capture the variety of ways a debtor's prepetition creditors share value, if they ever did. Critical vendor orders, debtor-in-possession loan roll-ups, gifting transactions, rights offerings, inducements to join a restructuring supporting agreement: these are just a few examples of practical innovations nowhere sanctioned in the Bankruptcy Code, but nevertheless in wide use as a matter of discretion and deeply inconsistent with a stock notion of priority.

Existing law even features analogs that work at a systematic level by establishing a kind of successor liability. The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) provides the most telling example.[104] The Act establishes private obligations to remediate or pay for the remediation of sites contaminated by the disposal of hazardous substances. It imposes joint and several liability on four categories of persons.[105] For our purposes, CERCLA is interesting because it imposes

102. *See, e.g.*, Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235 (2013); *see also, e.g.*, Skeel, *supra* note 41, at 713 (documenting "violations" of a supposed norm of pro rata treatment of creditors).

103. *See* Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581 (2016). The Justices did seem to have something like a Platonic hierarchy in mind in their most recent decision on the subject, *Czyewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017). *See* Buccola, *supra* note 42, at 10-16.

104. Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. §§ 9601-9675 (2018)). For discussion of the relationship between bankruptcy law, Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), and related environmental statutes, see Light, *supra* note 9, at 191-200.

105. 42 U.S.C. § 9607(a) (2018).

liability not only on the persons who owned relevant facilities at the time hazardous materials were disposed[106]—a kind of strict liability—and on persons working for the owners in relation to disposal,[107] but also on persons who own a relevant facility when the CERCLA action is brought.[108] The effect is to establish a kind of successor liability. Whoever is holding the land at the time of recovery must pay. The Act makes bankruptcy irrelevant. It does not matter if the current owner acquired the contaminated facility free-and-clear of claims against the polluter, because, as in traditional successor liability, the Act establishes the owner's liability directly—not just derivatively—through the polluter. The owner can seek contribution from other responsible parties. But the owner is on the hook. That means acquirers, whether inside or outside of bankruptcy, must factor potential liability into their valuations.

Nor is successor liability limited to toxic waste sites. Other environmental laws have adopted less onerous versions of successor liability. The Resource Conservation and Recovery Act, for example, establishes "cradle-to-grave" liability for all parties involved in the generation, treatment, storage, and disposal of hazardous waste.[109] The Surface Mining Coal Reclamation Act requires that every coal mine operator post a bond to ensure that land used for coal mining be restored to its original state.[110] These bonds follow the land, not the coal miner that originally incurred the cleanup obligation.[111]

Successor liability also operates outside of the environmental context. For example, the Supreme Court has found that the National Labor Relations Act imposes liability on successors "beyond the confines of the common law rule when necessary to protect important employment-related policies."[112] For this reason, labor law creates a presumption of a "substantial continuity" between a buyer's and seller's business with respect to the buyer's obligations to the seller's employees.[113] This presumption is

106. *Id.* § 9607(a)(2).

107. *Id.* § 9607(a)(3), (4).

108. *Id.* § 9607(a)(1).

109. *Id.*; *see also Learn the Basics of Hazardous Waste*, ENVTL. PROTECTION AGENCY (Feb. 19, 2020), https://www.epa.gov/hw/learn-basics-hazardous-waste#cradle [https://perma.cc/85NZ-XGBZ] (describing CERCLA and related environmental statutes).

110. *See* Surface Mining Control and Reclamation Act of 1977, Pub. L. No. 95-87, 91 Stat. 445 (codified as amended at 18 U.S.C. § 1114 (2018); and 30 U.S.C. §§ 1201-1211, 1231-1328 (2018)).

111. *See id.*

112. Einhorn v. M.L. Ruberton Constr. Co., 632 F.3d 89, 94 (3d Cir. 2011) (citing Golden State Bottling Co. v. NLRB, 414 U.S. 168, 182 (1973)). In *Golden State*, the Court found an asset purchaser to be a successor when the purchaser had notice of labor dispute when the purchaser acquired the seller's assets. *Golden State*, 414 U.S. at 182. *See also* John Wiley & Sons v. Livingston, 376 U.S. 543 (1964) (requiring a company to submit to arbitration with the union that represented employees of a predecessor company); NLRB v. Burns Int'l Sec. Svcs., 406 U.S. 272 (1972) (same).

113. Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 43 (1987).

intended to ensure that collective bargaining agreements are not "subject to the vagaries of an enterprise's transformation."[114] Employment law, too, often imposes successor liability and affords purchasers little flexibility to acquire assets free and clear of seller's liability under federal employment law.[115]

That a judicially managed super-durability norm would be unexceptional in preferring one class of unsecured creditor over others (and even over secured creditors) does not, of course, prove that it's a good idea. Perhaps no such rule is justified. Perhaps some are and others not. Some thoughtful commentators object to special pleading generally.[116] (We do, too, usually, unless it's justified.) We will argue the merits in Part III. The point here is just to see that our innovation structurally resembles common practices.

1. Preserving Successor Liability

The less aggressive way to implement the super-durability strategy would preserve state-law principles of successor liability. This implementation would not affirmatively *add* durability to what background principles of state law would provide, but it would undo the practice in bankruptcy of subverting those principles. The successful resolution of a Chapter 11 case, whether through a section 363 sale or a plan of reorganization, typically grants immunity to a transferee of assets who would otherwise face liability as a successor-in-interest for claims of the transferor's tort creditors. The gist is just to refuse to allow bankruptcy to wash tainted assets *free and clear* of successor liability when successor liability would otherwise attach. This is a relatively *safe* implementation, politically speaking, because it requires little affirmative action by bankruptcy judges. However, because the reach of successor liability is uncertain and context-specific, its effect would accordingly be muted.

The consequence of this limited intervention might be relatively small. They would depend on the importance of successor liability under state law. The downside of this method of implementation is that successor liability is an uncertain doctrine. It might not be applied by a subsequent state court or by a court in a different state. So it would work only

114. *Id.* at 38.

115. *Einhorn*, 632 F.3d at 93 (imposing successor liability for employment discrimination when the successor had notice, there was sufficient continuity of operations and workforce, and the seller failed to provide adequate relief); EEOC v. Vucitech, 842 F.2d 936, 945 (7th Cir.1988) (stating that, when the successor is aware of potential future liability, it will spend less to purchase the assets, and thus the seller that originally incurred liability will effectively bear the costs of liability); Musikiwamba v. ESSI, Inc., 760 F.2d 740, 746 (7th Cir. 1985) (finding successor liability for illegal employment practice on the ground that victim was unable to protect against change in business).

116. *See generally* Roe & Tung, *supra* note 102, at 1240-42 (arguing that attempts to alter priority rules leads to rent-seeking).

imperfectly. Still, we think this an improvement over the status quo, and one that could be achieved fairly easily.

2. Assumptions of Liability

A more aggressive approach would require that the reorganized debtor, or the buyer of the debtor's assets in a section 363 sale, affirmatively assume liability for existing and future tort claims. In other words, the disposition of the debtor's assets would establish successor liability without resort to uncertain, subsequent judicial implementation of the doctrine.

The aggressive implementation would call to mind *Chrysler* in some respects. The bankruptcy judge's performance in that case is a matter of intense controversy.[117] We want to be clear how our idea compares. The Chrysler and GM bankruptcies were devices by which the United States and Canadian governments poured money into the auto manufacturing industry. *Chrysler* was especially controversial among bankruptcy scholars and practitioners because Judge Gonzalez signed off on a bidding process and sale—pushed by the Auto Task Force—featuring liability assumptions similar to what we propose.

Here is how it worked.[118] Chrysler had almost $7 billion in secured debt outstanding. It entered bankruptcy with a scheme hammered out in consultation with the Obama administration's Auto Task Force. The plan was for a government-backed entity called New CarCo to acquire Chrysler's useful assets (and become integrated with Fiat, which held an equity stake in the acquirer). New CarCo made a stalking-horse bid to acquire Chrysler for $2 billion and to assume approximately $5 billion in unsecured obligations to retirees who were members of Chrysler's chief labor union, the United Auto Workers (UAW). It is not unusual for a buyer to assume some of a debtor's prepetition liabilities. But the magnitude of the assumption in *Chrysler* was unlike any previous transaction.[119] New CarCo also

117. For critical views, see, for example, Barry E. Adler, *A Reassessment of Reorganization Law After Chrysler and General Motors*, 18 AM. BANKR. INST. L. REV. 305 (2010); Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of* Chrysler *and* GM, 2010 U. ILL. L. REV. 1375; Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L.J. 663 (2009); Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727 (2010). For more sanguine evaluations, see, for example, Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 101, 109 (2009) ("In short, the basic structure used to reorganize both GM and Chrysler was not unprecedented. Indeed, it was entirely ordinary."); and Edward R. Morrison, *Chrysler, GM, and the Future of Chapter 11*, at 1 (Colum. L. & Econ. Research Paper No. 365, 2010), https://scholarship.law.columbia.edu/faculty_scholarship/2418/ [https://perma.cc/YNK3-8AY7]; *see also* Baird, *supra* note 61, at 281 (objecting on principle to one ruling but arguing its practical irrelevance).

118. *In re* Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009).

119. Roe & Chung, *supra* note 29, at 418-25 (comparing financial attributes of the Chrysler sale to those of previous section 363 going-concern sales).

agreed not to seek modifications of the collective bargaining agreements and to give the union pension fund an equity stake in the business. Thus, under the terms of the bid, the retirees' unsecured claims would be mostly or completely made whole, while the secured creditors would receive 29 cents on the dollar.

What was controversial as a matter of judicial policy, though, as opposed to the governments' political policy, was not the bid. It was Judge Gonzalez's acquiescence (later modified in part)[120] in New CarCo's proposed bidding procedures. New CarCo proposed that any competing bids be required to assume the same liabilities and make the same commitment to honor existing labor contracts. This seemed designed to preclude bids that exceeded New CarCo's $2 billion offer price, but that fell below its all-in investment of $10 billion. Secured creditors were understandably unhappy about the order, as were many bankruptcy scholars, who saw an ad hoc political intervention displacing the market-based norms of reorganization practice. As in our scheme, a bidder required to pay certain unsecured prepetition obligations can be expected to reduce its bid, which means less for the creditors whose recovery will come through the bankruptcy.

There are a few important points of contrast. Most importantly, the case for boosting tort creditors is stronger than the case for supporting the UAW in *Chrysler*. Tort creditors deserve a priority claim because they cannot price insolvency risk. That is not necessarily true for a large labor union.[121] The reason to protect the UAW in *Chrysler*, depending on who you were, had to do with sustaining labor peace (similar to a critical vendor order), sustaining an industry during a financial crisis, or winning votes. Second, the bidding procedures order in *Chrysler* was pushed by a lender and buyer who had social ambitions and were not simply trying to maximize return. Most cases presumably will not feature a DIP lender and stalking-horse bidder who demand that tort creditors be compensated in full. Third, the Chrysler intervention was designed to be anomalous. Some observers worried it would have a precedential effect.[122] It seems not to have

120. David A. Skeel, Jr., *From Chrysler and General Motors to Detroit*, 24 WIDENER L.J. 121, 136 (2015) ("[T]he bankruptcy judge in *Chrysler* did insist on a slight modification of the bidding rules. But the final rule fell far short of creating a meaningful auction. It required only that the debtor take a look at any non-qualifying bid, and then decide—after consultation with the U.S. Treasury and Chrysler's unions (as well as the creditors' committee), precisely the parties most interested in the government's arrangement—whether the non-qualifying bid should be considered." (footnote omitted) (citing *Chrysler*, 405 B.R. at 93, 108-09 & n.25)).

121. To be clear, we take no particular view in this Article about how retiree obligations *should* rank. It's just that the justifications for tort claims to rank first do not map comfortably to union-negotiated claims. *Cf.* Musikiwamba v. ESSI, Inc., 760 F.2d 740, 746 (7th Cir. 1985) (noting successor liability applies to section 1981 claims in part because employees are unable to protect against business sale).

122. *See* Brubaker & Tabb, *supra* note 117, at 1377 ("Although one might with considerable justification argue that *Chrysler* and *GM* were *sui generis*—and as a matter of law should be politely and discreetly ignored as once-in-a-century aberrations having more to do with political

had one, though,[123] probably because people recognized that the macroeconomic and political circumstances that led the administration to bail out the auto industry were unusual.[124]

III. Assessing a Super-Durability Norm

At first approximation, the consequences of a super-durability norm for tort claims would mimic those of a super-priority rule. In fact, with a few simplifying but in many cases useful assumptions, their effects would be identical. Both would force corporate managers and financiers to internalize the costs of strangers' injuries ex ante, and would do so without imposing a social loss ex post. Under real world conditions, a comparison is arguable. A super-durability norm may avoid some of the pitfalls of a super-priority rule, but would probably do so by exacerbating debt overhang problems.[125]

This Part assesses the effect of a super-durability norm. For ease of exposition, we consider the strong version of our proposal. To develop intuitions, we start with the world posited in Part I, where parties know the distribution of possible liabilities when financing decisions are made and know the extent of actual liability when restructuring becomes necessary. In this world, a super-durability norm performs exactly as a super-priority rule would. We then relax the model to consider scenarios where a debtor's tort liability is uncertain at the time of restructuring, where potential investors are asymmetrically informed about the liability, and where the liability is likely to exceed (or amount to a large percentage of) the total value of the debtor's assets. In these cases, our proposal could yield ex post inefficiencies that a statutory super-priority would not.[126] We suspect that institutional responses would minimize the impact of these inefficiencies. But depending on one's view, they could weigh in favor of a merely conditional or otherwise cautiously employed super-durability norm.

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and economic necessity than with legal precedent that anyone should take seriously—we suspect (indeed, to a virtual certainty) that such will not be the case."); Roe & Skeel, *supra* note 117, at 731 ("We can hope that the breach of proper practice will be confined to *Chrysler*. But the structure of the deal is not *Chrysler*-specific. Not only did the subsequent *General Motors* opinion rely heavily on *Chrysler*, but other courts and plan proponents will inevitably cite *Chrysler* as precedent. Some already have." (footnote omitted)).

123. Deniz Anginer & A. Joseph Warburton, *The Chrysler Effect: The Impact of the Chrysler Bailout on Borrowing Costs* (World Bank Policy Research Working Paper 5462, 2010), https://www.researchgate.net/publication/228252869_The_Chrysler_Effect_The_Impact_of_the_Chrysler_Bailout_on_Borrowing_Costs [https://perma.cc/M9K6-3UXL].

124. Morrison, *supra* note 117, at 1.

125. In the corporate finance literature, debt overhang describes any situation in which the existence of outstanding debt blunts investment incentives. *See* Vincent S.J. Buccola, *Beyond Insolvency*, 62 U. KAN. L. REV. 1 (2013) (discussing implications for law of recognizing solvency as a continuous rather than discrete variable).

126. Note, though, that many ex post inefficiencies are equally present in a super-priority world.

A. The Simple Case

Where the amount of a debtor's tort liability is known and the amount is less than the total value of the debtor's assets, a super-durable claim would replicate the effects of a super-priority claim. In such a scenario, both rules allow tort victims to recover in full, at the expense of even senior financial creditors. Both rules therefore force lenders and borrowers to internalize the expected costs of tortious activity.

To see how the two rules compare, return to the Acme hypothetical developed above. Specifically, recall our model of existing law applied to a project financed with secured debt and equity (scenario 2).[127] The project costs $10,000 and yields an asset worth either $14,000 (success) or $10,000 (failure), but in case of failure the business also generates $4000 of tort liability. If Acme were to finance the project with a 90/10 debt/equity ratio, the lenders would be made whole irrespective of the success or failure of the project, and tort creditors, should there be any, would be undercompensated. The result was that Acme would be willing to finance the project if it had as little as a 1-in-5 chance of success, compared to the 1-in-2 chance that would make investment socially optimal.

Scenario 2

Assumptions: (1) 90%/10% debt/equity, (2) limited liability & (3) *p* = probability of success

	Value in Success	***Value in Failure***	***Expected Value***
Tort Victims	0	1000 – 4000 = -3000	(1–*p*)(-3000)
Lender	9000 – 9000 = 0	9000 – 9000 = 0	0
Equity	5000 – 1000 = 4000	0 – 1000 = -1000	(*p*)(4000) + (1–*p*)(-1000)
Total Social Value	***4000***	***-4000***	***(p)(4000) + (1–p)(-4000)***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-5 (20%)

Consider, now, how the situation plays out under a super-durability norm. Unlike under a super-priority rule, the lender is entitled to be paid first from whatever the collateral realizes. The *waterfall* pays tort creditors only if there is value remaining after the lender is made whole. Now, however, the tort victims have a source of recovery outside the waterfall—namely, against the business's post-bankruptcy owner. The amount the post-bankruptcy financier is willing to pay for the business therefore depends on the financier's expectation of post-bankruptcy liability.[128] Some

127. *See supra* Section I.A.

128. We are not the first to notice this dynamic. *See, e.g.*, Zerand-Bernal Grp., Inc. v. Cox, 23 F.3d 159, 163 (7th Cir. 1994) (Posner, J.) ("Zerand points out that the price received in a

simple algebra yields a unique solution. If the post-bankruptcy financier would pay $10,000 for the business "free and clear," it pays only $6000 for the business subject to a super-durability rule. The lender is entitled to it all. This, after all, is what the bankruptcy estate receives and can distribute. The shareholders and tort victims get nothing from the bankruptcy. But because the bankruptcy yields them nothing, they can assert the entire $4000 of their claim against the post-bankruptcy business. The tort victims recover in full.

Scenario 5[129]

Assumptions: (1) 90%/10% debt/equity, (2) limited liability, (3) super-durability & (4) p = probability of success

	Value in Success	***Value in Failure***	***Expected Value***
Tort Victims	0	(0 – 4000) + 4000 = 0	0
Lender	9000 – 9000 = 0	6000 – 9000 = -3000	(1–p)(-3000)
Equity	5000 – 1000 = 4000	0 – 1000 = -1000	(p)(4000) + (1–p)(-1000)
Total Social Value	***4000***	***-4000***	***(p)(4000) + (1–p)(-4000)***

Breakeven Probability: Socially-Optimal: 1-in-2 (50%) vs. Equity: 1-in-5 (20%)

Super-durability replicates the payouts under a super-priority rule. Both align Acme's investment incentives with the socially optimal rule.

B. Complications

Under other, in some instances more realistic assumptions, a super-durability norm could produce ex-post inefficiencies that prevailing norms do not (and that a statutory super-priority would not). Note, though, that whether super-durability would produce such inefficiencies in practice depends on the efficacy of inter-creditor bargaining and the finesse with which bankruptcy judges manage their cases. These problems thus follow from the administrative costs of negotiating under uncertainty and from

bankruptcy sale will be lower if a court is free to disregard a condition in the sale agreement enjoining claims against the purchaser based on the sellers' misconduct. If the condition is invalid the purchaser will be buying a pig in a poke, never knowing when its seller's customers may come out of the woodwork and bring suit against it under some theory of successor liability. This possibility will depress the price of the bankrupt's assets, to the prejudice of creditors."); David Gray Carlson, *Successor Liability in Bankruptcy: Some Unifying Themes of Intertemporal Creditor Priorities Created by Running Covenants, Products Liability, and Toxic-Waste Cleanup*, 50 L. & CONTEMP. PROBS. 119, 120 (1987) ("A solvent buyer of . . . encumbered property will discount the purchase price by the amount of the expected inherited personal liability, and to this extent, the recovery of present creditors will be diminished in bankruptcy . . . .").

129. The differences between scenarios 4 and 4a also apply to scenario 5.

facilitating coordination among tort claimants—not because debt overhang is a problem in and of itself.[130] Below we explain why we expect parties to manage these ex post inefficiencies contractually. Here we outline potential downsides of a super-durability norm.

1. Claim Value Uncertainty (Symmetric Information)

The precise amount of a debtor's tort liability is likely to be known at the time of a bankruptcy filing only in cases involving relatively small companies. For smaller businesses, an adverse judgment may be the cause of Chapter 11. Many debtors, including larger companies for whom tort liability is a factor in the decision to use bankruptcy, will by contrast face predominantly unliquidated claims. A dark cloud hangs over the business, but no one is quite sure how much it will rain.

For purposes of modeling investor reactions, an assumption of certainty can be useful even in cases involving doubt. Experienced lawyers and litigation financiers can produce reasonably accurate liability estimates if relevant conduct and the number and demographic circumstances of the claimants can be established.

In other cases, however, the standard error of even the best estimates is too large. Uncertainty might derive from a lag between culpable behavior and manifest injury. Parties might know about a debtor's culpable conduct, but not the conduct's reach or the harms it will eventually cause. The asbestos cases provide the most salient, but hardly the only example. Some pharmaceutical liability has a similar structure.[131] Uncertainty might alternatively derive from ignorance about the existence or nature of culpable conduct. Parties might not know, for example, that a debtor's cars have been engineered to falsify carbon admissions.[132]

Where the amount of a debtor's tort liability is highly uncertain, and where the potential post-bankruptcy financiers are risk-averse, a super-durability norm may produce ex-post inefficiency that a super-priority rule would not. Reckonings have value. In the presence of uncertainty, risk-averse financiers will discount their bids. Moreover, as uncertainty increases, so too does the chance that the highest bid represents not the best

130. Ken Ayotte and David Skeel have made a related point in connecting debt overhang to coordination challenges. *See* Kenneth Ayotte & David A. Skeel Jr., *Bankruptcy Law as a Liquidity Provider*, 80 U. CHI. L. REV. 1557, 1573 (2013) ("[T]he debt-overhang problem, like the common-pool problem, is fundamentally a problem of coordinating multiple creditors.").

131. *See* Nate Raymond, *Indivior to Pay $600 Million to Settle U.S. Opioid Treatment Marketing Claims*, REUTERS (Jul. 24, 2020), https://www.reuters.com/article/us-usa-indivior-settlement/indivior-to-pay-600-million-to-settle-u-s-opioid-treatment-marketing-claims-idUSKCN24P1W5 [https://perma.cc/5K8H-HXMS].

132. *See* Guilbert Gats, Jack Ewing, Karl Russell & Derek Watkins, *How Volkswagen's 'Defeat Devices' Worked*, N.Y. TIMES (Mar. 16, 2017), https://www.nytimes.com/interactive/2015/business/international/vw-diesel-emissions-scandal-explained.html [https://perma.cc/H2US-QXE4].

use of the debtor's assets, but merely the owners least sensitive to uncertainty. A super-durability norm is not designed to produce certainty.[133] Prevailing bankruptcy norms are. Free-and-clear sales give the buyer certainty—not perfect certainty, given the doctrine,[134] but a good measure. Proceeds are paid out under a strict waterfall, especially if the case is converted to Chapter 7, or else under agreed terms. Free-and-clear plans allocate cash and ownership interests in the reorganized company according to a negotiated settlement or, if need be, judicial estimation.[135] Not so with a super-durability norm. If tort claims are durable, and if tort creditors insist on durability rather than an alternative proposed recovery *through the bankruptcy process*, then neither a sale nor a plan can fully resolve uncertainty.

Note, though, that certainty for financial creditors under a super-priority regime does not mean that super-priority is clearly preferable to super-durability. When future tort liability is uncertain, tort claimants will recover based on an estimate of the value of their claims. Bankruptcy judges cannot know the precise value of tort claims that will only manifest years in the future. Under a super-priority rule, bankruptcy judges will set aside funds to pay the tort claimants based on an estimate of the damages tort victims will suffer in the future.[136] There is therefore a tradeoff between a super-priority rule and a super-durability rule. In settling all the debtor's affairs in the bankruptcy proceeding, the super-priority rule gives financiers certainty about the extent of tort liability they will be exposed to in the future. In doing so, a super-priority rule increases the likelihood that assets will continue to be put to productive use.

Certainty for financial creditors, however, comes at the expense of certainty for tort creditors, whose claims might be able to be valued with precision if they are brought when the harm occurs but not when their

133. Though, as we explain presently, a super-durability norm could facilitate negotiation between tort claimants and other stakeholders. In such cases, a super-durability norm would not lead to increased uncertainty.

134. *See supra* Section II.C.

135. *See, e.g.*, Epstein v. Official Comm. of Unsecured Creditors (*In re* Piper Aircraft, Corp.), 58 F.3d 1573 (11th Cir. 1995); Olson v. Frederico (*In re* Grumman Olson Indus., Inc.), 445 B.R. 243 (Bankr. S.D.N.Y. 2011) (holding that known tort claims are paid by the seller—not the buyer—in a section 363 sale, but that the buyer remains liable to future tort victims who had not yet been injured at the time of the sale).

136. Asbestos litigation led to a number of these trusts, and difficulties assessing the magnitude of harms caused by asbestos exposure left many of these trusts underfunded and left future claimants uncertain about their ability to recover. *See* Mark D. Plevin, Leslie A. Epley & Clifton S. Elgarten, *The Future Claims Representative in Prepackaged Asbestos Bankruptcies: Conflicts of Interest, Strange Alliances, and Unfamiliar Duties for Burdened Bankruptcy Courts*, 62 N.Y.U. ANN. SURV. AM. L. 271, 277 (2006) (summarizing this phenomenon in the context of the Johns-Manville asbestos trust); Stephen Labaton, *The Bitter Fight over the Manville Trust*, N.Y. TIMES (July 8, 1990), https://www.nytimes.com/1990/07/08/business/the-bitter-fight-over-the-manville-trust.html [https://perma.cc/LXH3-NMRD] (stating that the Manville Trust was "looted" just two years after it was created); *see also* RICHARD A. NAGAREDA, MASS TORTS IN A WORLD OF SETTLEMENT 75 (2007) ("The Manville trust proved to be a perilous institution . . . with large numbers of claims quickly overwhelming its initial capitalization.").

claims must be settled prospectively. Neither rule is perfect, and the superiority of one regime may depend on one's views about whether it is preferable to allow financiers to extend credit without being exposed to future tort liability, or whether it is preferable to give tort claimants an opportunity to collect based on the harms they actually suffer—not the harms they expect to suffer in the future.

Moreover, the extent of ex-post inefficiency that would result from a super-durability norm depends on the ability of parties to negotiate among themselves. As we discuss in more detail below, judicial finesse and bargaining among creditor representatives are key to the ex post efficiency of a super-durability norm in the presence of uncertainty. If a debtor's investors—understood broadly to include both financial creditors and involuntary claimants—can realize a surplus from including a free-and-clear provision, then there is at least a notional (Coasean) deal to be struck. Especially in smaller cases, that ought to work fine. A universally agreed deal might be less likely to emerge in mass tort cases with hundreds or thousands of tort claimants, especially if they lack aggregate representation, or if there are multiple, differentially situated classes of tort claimants. We see a role for judicial discretion to encourage surplus-yielding deals.

2. Claim Value Uncertainty (Asymmetric Information)

A more pointed complication arises where parties are asymmetrically informed about the amount of a debtor's uncertain tort liability. Outsiders who might finance a business post-bankruptcy worry about a form of adverse selection.[137] If tort claims can be asserted against the post-bankruptcy business, then the value of that business is a function of the amount of the liability.[138] And if outsiders think that insiders have both superior information and the capacity themselves to become post-bankruptcy financiers, then outsiders will reduce their bids, relative to what they would bid if information were symmetric, so as not to become cursed winners.[139] The intuition is straightforward: why would insiders allow a bid to win unless they believe it underestimates the magnitude of liability? In equilibrium, information asymmetry tends to lock incumbents in place and depress investors'

137. *See* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 277 (1984) (describing adverse selection in the context of acquisition agreements and arguing that the seller is the most efficient information provider).

138. The value also depends, of course, on the cash flows the assets are expected to produce. Insiders can have private information about either variable; we just happen to be focused on tort liability rules. For discussion of asymmetric information about the value of debtors' assets, see Ayotte & Skeel, *supra* note 130, at 1579-85.

139. *Cf.* Choi, *supra* note 73, at 418-26 (modeling this dynamic in the M&A rather than bankruptcy setting).

recoveries.[140] Dynamically, the expectation of asymmetric information will tend to increase the cost of capital in industries most likely to generate opaque tort liabilities.

But the problem of asymmetric information is endemic in all bankruptcies and not unique to tort claimants.[141] Managers simply know more than an arm's-length financier about every facet of operations that cannot be, or in any case is not, quantified. That can be true about the size of contingent or unmatured tort liabilities, the likelihood that a product will turn out to be defective, and the firm's production costs and operating expenses.

Still, there is reason to think that asymmetric information is especially problematic in the context of tort claims. Insiders are more likely to know if the company has dumped toxic chemicals—and if so, where and how much—or if its products have proved faulty or dangerous in some circumstances, or if allegations of harassment made to Human Resources constitute a pattern or practice, and so on. Disparities in information will loom larger in some cases than others.

One should not overstate the role that asymmetric information about tort liability is likely play in the ordinary case, however. To repeat what we have said already, in a significant fraction of cases, especially those involving smaller businesses, the extent of tort liability will be common knowledge. In cases where the amount of liability is highly uncertain, the people with relevant knowledge may not be potential post-bankruptcy financiers. A prospective, outsider financier will mainly be concerned about the information base of banks and investment funds with longstanding relationships to the debtor. But how likely are they to know much more than an outsider about, say, the cause of wildfires in Northern California, or the extent of junior employees' bid rigging or bribery? The answer, of course, is that it depends.

In any event, the prevailing free-and-clear norm unwinds adverse-selection dynamics to a large extent.[142] It does so not by equalizing access to information, but by making information about expected tort liability irrelevant. The amount of prepetition tort liability matters to the value of the post-bankruptcy business only if tort creditors can assert claims against it. That is what a free-and-clear norm says is off the table.

A super-durability norm, by contrast, exacerbates the information-asymmetry problems that already exist in bankruptcy. Just as one might expect incumbent management to be well-informed about the value of the assets it is selling, so too would one expect managers to have a more accurate sense of future tort liability than prospective buyers. In this way, a

140. *Id.* For a general model of common-value auction dynamics with asymmetric information, see Richard Engelbrecht-Wiggans, Paul R. Milgrom & Robert J. Weber, *Competitive Bidding and Private Information*, 11 J. MATHEMATICAL ECON. 161 (1983).

141. *See* Ayotte & Skeel, *supra* note 130, at 1579-81.

142. For an analogous mechanism, see *id.* at 1594.

durability norm creates an additional reason for buyers and financiers to worry that sellers are refusing to disclose information that is relevant to the purchase price.

But again, there are compelling reasons to think that institutional responses will mitigate—or even eliminate—the moral hazard problem generated by information asymmetries. Information asymmetry is not unique to bankruptcy. It is also one of the principal challenges in ordinary mergers and acquisitions.[143] Yet parties have developed a contractual solution to the issue. Representations and warranties—often referred to as "reps"—are contractual promises about the veracity of a fact that is relevant to an asset sale.[144] According to Stuart Gilson, the "primary purpose" of the representations and warranties sections of acquisition agreements is "to remedy conditions of asymmetrical information in the least cost manner."[145] Reps offer an elegant solution to the information asymmetry problem, because they encourage the party that has information relevant to an asset's price to disclose that information. Buyers use reps to protect themselves against all sorts of claims, from sexual harassment to labor liability to false or misleading information regarding the seller's assets and liabilities.[146]

It is in the interest of both buyers and sellers for sellers to make their private information available to prospective buyers. A buyer that fears that a seller has information that would depress the buyer's evaluation of the value of the business will pay less—or perhaps not even submit a bid in the first place—in response to the possibility that the buyer is hiding negative information. The disclosure thus reduces uncertainty and eliminates the transaction costs the seller incurs trying to acquire information relevant to its offer price.[147]

Unlike ordinary mergers and acquisitions, an insolvent firm is unlikely to be able to use reps to resolve the information asymmetry problem. An insolvent seller will distribute the proceeds of a sale and wind up its business. The buyer cannot indemnify the seller against false representations for the simple reason that the buyer lacks the resources to do so. A seller will therefore find scant assurance from a contractual provision in which the seller agrees to cover any future liabilities that result from the seller's

143. *See* Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 856 ("The challenge of contract design is largely the management of information problems.").

144. Technically, a representation does not give rise to liability unless a party justifiably relied on the representation whereas warranties are provisions of the contract that give rise to liability regardless of whether or not there was justifiable reliance. *See* CBS Inc. v. Ziff-Davis Publ'g, Co., 553 N.E.2d 997 (N.Y. 1990).

145. *See* Gilson, *supra* note 137, at 269.

146. *See* Sean J. Griffith, *Deal Insurance: Representation and Warranty Insurance in Mergers and Acquisitions*, 104 MINN. L. REV. 1839, 1840-41 (2020).

147. For extended discussion of this phenomenon, see Gilson, *supra* note 137, at 268-74.

behavior if the seller ceases to exist or lacks the funds to honor that commitment.

It is not clear, however, why insurance would fail to mitigate this issue. Sean Griffith has recently documented the rapid growth of representation and warranty insurance (RWI) in private M&A deals.[148] Though this form of insurance was extremely rare just a decade ago, today at least twenty insurers offer RWI, with coverage extending as high as $1 billion.[149] As a practical matter, then, it seems that there is a market for insurance against future tort liability—at least in the context of M&A, where buyers bear some risk of being held liable for the activities of the seller.

Under current bankruptcy law, there is no reason for an insurance company to offer protection against an insolvent debtor's tort liability. Because bankruptcy allows buyers and sellers to externalize the costs of tort liability onto victims by selling assets free and clear of encumbrances, neither buyers nor sellers in a bankruptcy proceeding will expect to bear the costs of sellers' tortious conduct. The ability to use bankruptcy to shed tort liability thus ensures that there is no demand for insurance against claims that stemmed from a bankrupt debtor's tortious conduct.

However, if bankruptcy judges developed a durability norm in which a seller's tort liability passed on to the buyer, they would thereby create a market for insurance that would protect buyers from liability for sellers' tortious conduct. A leveraged company might purchase insurance in order to reassure prospective buyers about their potential exposure to future liability.[150] Alternatively, the acquirer would purchase insurance for the deal itself. Either way, the insiders would bear the cost of the asymmetry, because it will result in a discount to what the outsiders will pay. Given the robust market for insurance in M&A deals, there is reason to think that such a market would emerge in bankruptcy if buyers were held liable for the debtors' tortious conduct.

Insurance would, moreover, encourage distressed firms to continue to monitor their activities and limit their tortious conduct. Michael Ohlrogge recently found that distressed firms are seven times more likely to engage in Clean Water Act violations, and that the prospect of successor liability has a substantial deterrent effect.[151] The implication is that distressed firms have little reason to comply with environmental laws when they can expect to socialize those costs in bankruptcy, but that successor liability encourages distressed firms to comply with environmental laws because doing so

148. *See* Griffith, *supra* note 146, at 1843 (finding that RWI was used in thirty to fifty percent of deals in which neither party is publicly traded).

149. *See id.*

150. Painter, *supra* note 12, at 1076 ("In general, if a firm's voluntary creditors are threatened by tort claims, they will have an incentive to monitor the manufacturer's potentially tortious behavior and to force the manufacturer to purchase adequate insurance.").

151. *See* Ohlrogge, *supra* note 45.

helps to reassure prospective buyers that the sellers' assets are saddled with environmental obligations. Insurers, too, could be expected to investigate a firm's exposure to tort liability and charge lower premiums when it appears that a firm has little exposure to tort liability.[152] To the extent that insurance would cover tort liability, it would go a long way towards resolving the information asymmetry problem.

3. Liabilities Exceed Value of Business

A third important complication involves what we call *hot potato* assets. This problem arises when the amount of a debtor's tort liability equals, or even exceeds, the value of the cash flows the debtor's assets can be expected to generate. This is a type of debt overhang problem.[153] In extreme circumstances, the debt overhang problem might cause potentially productive assets to go unused. No one wants to acquire an asset that comes with liability that is equal to or greater than the value of the asset. It is plausible, though, that even these extreme cases would not idle productive assets. It would be rational for tort claimants to either accept payment in exchange for waiving their claims against the successor entity, or themselves to take equity in the successor entity. Durability would thus facilitate bargaining between tort claimants and other creditors. And in less extreme cases, debt overhang may cause an owner to underinvest in complementary resources.[154]

In theory, though, debt overhang could pose genuine challenges to the development of a super-durability norm. The ceiling on potential liability in mass tort is almost unlimited. Think of asbestos, tobacco, or opioids. The fact that a given line of business has proved to generate large liabilities also diminishes asset values. Certain environmentally degraded parcels of land arguably exhibit hot potato qualities.[155] There are statutes imposing cleanup liability on owners.[156] These operate like successor liability rules. Some plots are not worth owning at any price, because the statutory liability will doubtless exceed the value of correlative cash flows. Imagine, for example, that a bankruptcy judge insisted that the firm that purchased the

152. *Cf.* John Rappaport, *How Private Insurers Regulate Public Police*, 130 HARV. L. REV. 1539, 1540-41 (2017) (finding that insurers play a substantial role in monitoring police behavior).

153. *See* Stewart C. Myers, *Determinants of Corporate Borrowing*, 5 J. FIN. ECON. 147 (1977).

154. *See* Ayotte & Skeel, *supra* note 130, at 1570-72.

155. *See EPA Announces Superfund Task Force*, ENVTL. PROT. AGENCY (May 22, 2017), https://archive.epa.gov/epa/newsreleases/epa-announces-superfund-task-force.html [https://perma.cc/MQK2-J3BF] (arguing that CERCLA has led to hot potato assets).

156. *See* Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C. §§ 9601-9675 (2018)); Surface Mining Control and Reclamation Act of 1977, Pub. L. No. 95-87, 91 Stat. 445 (codified as amended at 18 U.S.C. § 1114 (2018); and 30 U.S.C. §§ 1201-1211, 1231-1328 (2018)).

Weinstein Company's film rights compensate the victims of Harvey Weinstein's sexual assault in full, and that the prospect of doing so deterred all prospective buyers from purchasing the company's film rights. In such circumstances, the durability norm would harm all parties. The movie rights are, presumably, worth something. All claimants—including tort claimants—would prefer to realize that value and not have the specter of future liability block an asset sale that would have allowed them at least a partial recovery.

Indeed, debt overhang is one of the central problems toward which bankruptcy is addressed.[157] The free-and-clear norm avoids the hot potato problem. Since the free-and-clear norm allows buyers to shield themselves from the bankrupt debtor's tort liability, it eliminates debt overhang and, in doing so, avoids the hot potato problem.[158]

There are, however, reasons to think that a durability norm would not create a hot potato problem. Debt overhang is a *problem* in only a subset of the situations in which it prevents assets from being put to productive use. Outstanding debts may block asset transfers for a number of reasons, only some of which are inefficient. When the social costs of using an asset exceed its expected future cash flows, the asset should not be considered an asset. It should be considered a liability. If the only way for an asset to generate value is for owners to shed liabilities that unavoidably accompany the use of the asset, then the asset has a negative social value, and it should be abandoned. Environmental liabilities can sometimes be understood in this way. If, for example, the costs of reclaiming a coal mine exceeds the expected future cash flows that the coal mine can be expected to generate, then the coal mine imposes costs that exceed the market value of the coal the mine could produce. Regulations are designed to force firms to internalize some of the social costs associated with an activity. If bankruptcy allows firms to extricate themselves from these regulatory costs, and if doing so is the only reason that an asset retains a positive value, then the problem is that bankruptcy allows entities to continue to make a profit off of goods even when the costs of using those goods exceed their value.[159]

Other liabilities, however, are not intrinsic to an asset. A durability norm that prevents asset transfers might be inefficient in these situations. There is reason, for example, to think that the Weinstein Company's film rights are valuable despite Harvey Weinstein's alleged sexual assault. The fact that Harvey Weinstein's actions generated massive tort liabilities does not mean that his film rights have a negative value. It would harm tort claimants if successor liability prevented would-be buyers from purchasing the Weinstein Company's film rights. Tort claimants can be expected to

157. *See, e.g.*, Ayotte & Skeel, *supra* note 130, at 1570-72.

158. *See id.* at 1592-94.

159. For an extended analysis of this issue, see Macey & Salovaara, *supra* note 13, at 932-41.

recover something from an asset sale, but they would recover nothing if the prospect of successor liability prevented the company's films from being put to productive use. It is in these circumstances that a super-durability norm generates a debt overhang problem.

It is not clear, however, that the debt overhang problem would be a problem in practice. Concern about debt overhang is based on the view that administrative costs would prevent tort claimants and potential buyers from reaching a mutually beneficial agreement. In addition to the possibility, discussed above, that firms would purchase insurance to protect themselves from precisely this type of situation, there is also reason to think that tort victims would not block asset sales when doing so would bar them from recovery. Bankruptcy judges routinely appoint a future claimants representative (FCR) to advocate on behalf of parties whose claims have not yet matured and who therefore are unable to participate in bankruptcy proceedings. When bankruptcy judges expect future claims to be significant, they often create a trust to pay these claimants and issue a *channeling injunction* that channels claims away from the debtor and into the trust. The channeling injunction prevents future claimants from asserting claims against anyone other than the trust that was established to pay future claimants.[160]

Though bankruptcy judges now have statutory authority to appoint an FCR and issue a channeling injunction,[161] these devices originated not from Congress, but from bankruptcy judges who felt that they needed to protect future asbestos claimants who could not represent themselves in the asbestos bankruptcies.[162] While it is difficult to calculate the size of future liabilities with precision, these trusts have allowed assets to be put to productive use while ensuring that tort claimants are able to bring what might otherwise have been foreclosed by the debtor's decision to file for bankruptcy protection.[163]

Super-durability, if applied blindly, has downside in mass liability situations. But tort victims would only harm themselves if they prevented themselves from recovery by blocking asset sales. When a company's tort liability threatens to block an asset sale, tort claimants can be expected to bargain in the shadow of the law. While coordination or holdup problems might deter prospective buyers that do not want to negotiate directly with potentially thousands of tort claimants, current law gives bankruptcy judges authority to mitigate these challenges. By appointing a future claimants' representative to negotiate on behalf of tort claimants, bankruptcy judges could appoint a representative who would have a legal obligation to

160. *See In re* Fairbanks Co., 601 B.R. 831 (Bankr. N.D. Ga. 2019).

161. *See* 11 U.S.C. § 524 (2018).

162. *See* H.R. REP. NO. 103-835, at 40 (1994).

163. *See id.*

negotiate in good faith on behalf of tort victims. When debt overhang threatened to block an asset sale, the FCR would likely accept a payment from a would-be buyer and agree to forfeit claims against the reorganized firm. The alternative would be to prevent tort claimants from receiving any compensation. In fact, courts have held that the FCR must be impartial and diligently represent the interests of future claimants.[164] It would likely be a violation of this duty if the representative's refusal to settle impeded an asset transfer that would have allowed future claimants to receive some compensation.

Thus, when there is a significant debt overhang, it is reasonable to expect a super-durability norm to precisely mimic the effect of a super-priority rule. A durability norm theoretically would give tort claimants a right to collect from the entity that emerges from bankruptcy (or that acquires the bankrupt's assets in a 363 sale). Instead of blocking an asset sale, a durability norm might instead facilitate bargaining between tort claimants and prospective buyers.

C. Institutional Responses

The previous section explained how uncertainty, asymmetric information, and debt overhang pose challenges for our super-durability proposal. It also argued that there are reasons to think that these concerns are overstated. The existence of insurance in ordinary asset sales suggests that insurance companies would offer to protect buyers from a bankrupt debtor's tort liability. Moreover, even when tort claims threaten to block an asset transfer, tort victims can be expected either to take over the bankrupt firm's assets themselves, or to authorize a free and clear sale to maximize their own recovery. There is, however, one additional reason to think that corporations will be able to manage a super-durability bankruptcy norm: when buyers have been held liable for the debts of their bankrupt predecessors, they have managed those risks successfully.

1. Insurance

There is reason to think that insurance companies will provide coverage against an insolvent debtor's tort liability to companies that purchase assets from a bankruptcy estate. There are exceptions to the general rule that a bankruptcy estate should emerge free and clear of debts and encumbrances. In some situations, those exceptions are significant. The obligation to reclaim land degraded by coal mining, for example, remains with whatever company acquires the coal mine.[165] The coal mining industry is

164. *In re* Combustion Eng'g, Inc., 391 F.3d 190, 234 n.45 (3d Cir. 2004).

165. *See* 30 U.S.C. § 1265(a)-(b) (2018) (requiring that all coal mining permittees post a performance bond guaranteeing reclamation).

currently in significant distress. At least sixty percent of coal is mined by companies that have filed for bankruptcy protection in the past five years.[166] Nonetheless, more than $10 billion of coal reclamation obligations is guaranteed by third-party insurers.[167] Those insurers have agreed to reclaim coal mines in the event that the coal mine operators—most of whom purchased the mines in the recent wave of coal bankruptcies—are unable to do so.[168]

Nor is coal mining unique. As discussed above, many environmental obligations—and not simply coal cleanup obligations—stay with the land and therefore pass on to the entity that purchases land with which environmental obligations are associated. A robust market for CERCLA insurance has emerged to protect toxic polluters from CERCLA liability, and today, a majority of CERCLA claims involve disputes about how to allocate costs among different insurance providers.[169] Similarly, not all tort claims are wiped out in bankruptcy. Tort claims that were unknown at the time of the bankruptcy can often be brought against the reorganized firm. The rapid development of RWI, in addition to the existence of insurance that protects specifically against successor liability claims, again implies that markets will devise ways to put socially valuable assets to productive use, even if firms could not shed tort liabilities incurred by the bankrupt debtor.[170] Insurance, it seems, is capable of managing the potential costs of a durability norm.

2. Bargaining in the Shadow of the Law

There is also reason to think that the prospect of sizeable successor liability would facilitate—not impede—bargaining among parties to the bankruptcy proceeding. In the wave of coal mining company bankruptcies that swept across the country between 2015 and 2017, state environmental regulators were legally entitled to insist that companies fully reclaim coal mines.[171] There was a plausible argument that the liability was non-dischargeable. The problem, however, was that bankrupt coal firms seemed

166. *See* Becky Yerak, *Bets on Coal End Where They Started: In Bankruptcy*, WALL ST. J. (Nov. 24, 2019), https://www.wsj.com/articles/bets-on-coal-end-where-they-started-in-bankruptcy-11574604000 [https://perma.cc/L99P-WVA4].

167. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-18-305, COAL MINE RECLAMATION (2018).

168. *See id.*

169. *See* Peter E. Seley & Zia C. Oatley, *Insurance and Equity in CERCLA*, BLOOMBERG L. REP. (2009), https://www.gibsondunn.com/wp-content/uploads/documents/publications/Seley-Oatley-InsuranceandEquityInCERCLA.pdf [https://perma.cc/T8VE-KPLA].

170. *See Mergers and Acquisition Insurance*, AIG, https://www.aig.com/business/insurance/mergers-and-acquisitions [https://perma.cc/PKM2-SFFC] (describing insurance options available to firms).

171. *See* U.S.'s Objections to Confirmation of Debtors' Plan of Reorg. at 2, *In re* Alpha Nat. Res., Inc., No. 15-33896 (Bankr. E.D. Va. June 29, 2016), ECF No. 2855.

unable to honor their cleanup obligations.[172] Environmental claimants were thus in a position to prevent coal companies from reorganizing. In doing so, however, environmental regulators would have hurt themselves, because the expected distribution would not have covered the costs of reclamation.[173] But instead of blocking coal mining companies from selling their assets, environmental regulators instead agreed to accept a super-priority claim on some of the bankrupt coal mining company's assets.[174] These agreements ensured that coal mining companies were able to emerge from bankruptcy and thus increased the likelihood that land used for coal mining would be reclaimed.[175]

In fact, when tort claimants are in a position to block bankruptcy sales, they seem to prefer to accept a reduced payment. In recent opioid bankruptcies, pharmaceutical companies' tort liability dwarfed other claims.[176] It would have been impossible for tort victims to insist that they be made whole. They therefore accepted a settlement and agreed to waive future opioid-related claims.[177] Again, there is little evidence that tort claimants will block an asset sale when doing so is harmful to their own interests. It instead appears that strong tort claims simply allow tort claimants to get a seat at the bankruptcy table and negotiate to receive some of the proceeds of the reorganization or asset sale.

D. Summary

A super-durability norm would improve on the status quo in many, if not all, circumstances. In situations where the magnitude of a debtor's tort liabilities is relatively certain and not so large as to preclude a post-bankruptcy financier's making complementary investments, super-durability mimics a super-priority rule. It produces better ex-ante incentives than the status quo rule does without sacrificing realized value ex post.

The calculus is more complicated in cases where tort liabilities are highly uncertain and debt overhang is a worry. It would of course be a strike against super-durability if the norm were apt to interfere with the imperative that productive resources be put to their best use. Skeptics might worry that durability could impede high-value asset sales and reorganizations. After all, if new owners believe they will be buried under a mountain of tort debt irrespective of what happens in bankruptcy, or if

172. *Id.* at 2.

173. *See id.*

174. Second Amended Disclosure Statement with Respect to Second Amended Joint Plan of Reorg. of Debtors & Debtors in Possession at 32, *Alpha Nat. Res., Inc.*, No. 15-33896, ECF No. 2528.

175. *See id.*

176. *See* Jan Hoffman, *Payout from a National Opioids Settlement Won't Be as Big as Hoped*, N.Y. TIMES (Feb. 17, 2020), https://www.nytimes.com/2020/02/17/health/national-opioid-settlement.html [https://perma.cc/LX7R-UV73].

177. *See id.*

they struggle to estimate exposure, they will incline to bid cautiously and abstain from complementary investment. Consequently, the value of the debtor's assets could be depressed. A virtue of existing bankruptcy practice, under this line of thought, is its capacity to match the debtor's assets with an optimal balance sheet.

But this line of criticism understates the capacity both of market institutions to respond to the possibility of a new source of debt overhang and of creditors themselves to bargain around the problem when it manifests. Despite the conventional wisdom—and the approximation we ourselves have indulged—that a buyer or reorganized company takes the debtor's assets free-and-clear of involuntary claims, the reality is more complicated. Existing law draws exceptions to the rule. Tort claims arising post-petition, for example, can pass onto the reorganized firm.[178] Many environmental obligations likewise pass through bankruptcy to successor entities.[179] These rules do not seem to have prevented resources from being put to productive use, however. What they have done is encourage the development of insurance markets to reduce risk and, if the empirical results are to be believed, induce legal compliance.[180]

There is also every reason to think that tort claimants would bargain with other stakeholders to relinquish durability when debt overhang would otherwise threaten their joint return. In cases where it might matter, tort claimants—or a representative in the bankruptcy—should be willing to relinquish durability. If an asset sale is the preferred resolution and an attractive buyer requires certainty or lower leverage, tort creditors can maximize their own recovery by surrendering durability. If a bona fide reorganization is the preferred resolution, tort creditors might be able to maximize their recovery by accepting equity. This is not to say that every mutually agreeable deal will in fact be concluded. That would be a fantasy. But between direct bargains and third-party mediated solutions, a super-durability norm seems unlikely to challenge the economic imperative of assuring the productive use of resources. Instead it looks like a mechanism for putting involuntary creditors in a stronger bargaining position and thereby increasing their expected recovery.

Ultimately, though, a durability norm could be expected to produce partially offsetting effects relative to the status quo: pro-social ex-ante incentives, but at the risk of putting assets to less than their highest-value use ex post. How these effects should be expected to trade off depends on facts

178. *See In re* Res. Tech. Corp., 662 F.3d 472 (7th Cir. 2011) (discussing the history and justification of administrative expense priority).

179. *See, e.g.*, United States v. Apex Oil Co., 579 F.3d 734 (7th Cir. 2009).

180. Michael Ohlrogge, Bankruptcy Claim Dischargeability and Public Externalities: Evidence from a Natural Experiment (Feb. 21, 2020) (unpublished manuscript), https://ssrn.com/abstract=3273486 [https://perma.cc/WT64-MD6W] (finding evidence that a judicial decision making certain cleanup orders non-dischargeable in bankruptcy caused firms within the decision's territorial jurisdiction to become more cautious in their disposal practices and tightened credit to such firms).

about bankruptcy institutions—roughly speaking, the agility of creditors and judges—on which reasonable minds can differ.

IV. Objections

We have promoted the super-durability strategy on pragmatic grounds. A motivating premise is the political infeasibility of legislative solutions to bankruptcy's tort problem. State legislatures are not going to revoke shareholder limited liability for corporate torts, and Congress is not going to add a super-priority rule for tort creditors to the Bankruptcy Code any time soon. Because turnabout is fair play, our own proposal must survive a reality check. In this Part, we outline and respond to the two most important practical objections to our approach.

A. Chapter 11 Avoidance

The first objection is that those who would lose from a system with super-durable tort claims will avoid using Chapter 11 even where using it would maximize economic value. Chapter 11 is not the only way for a company's financial distress to be resolved.[181] A variety of state-law mechanisms—the receivership, the foreclosure sale, the assignment for the benefit of creditors—can preserve a going concern, even if they are frequently clumsy for sizeable operations. The same mechanisms, along with Chapter 7 of the Bankruptcy Code, can also be used to resolve distress with a piecemeal liquidation of the business's assets.

The financial creditors of a company with significant tort liabilities might lobby to use one of these other mechanisms if Chapter 11 were to become sufficiently hostile. Claimants may prefer to be paid first out of a relatively small pool of assets than to be paid second out of a relatively big pool. The risk is that super-durability becomes a kind of Maginot principle. If the interests of tort creditors are heavily fortified in Chapter 11—but only there—then the managers and financial creditors of a distressed business might just go around it.[182]

There is, however, reason to suspect that Chapter 11 avoidance would have only modest effects on the managerial incentives to take precautions that motivate our project.

First, state-law reorganization mechanisms do not reliably extinguish tort creditors' claims. Under the Uniform Commercial Code, properly

181. For an accessible account of many of the regimes, see STEPHEN J. LUBBEN, THE LAW OF FAILURE (2018).

182. Strategic behavior in a world where substantive entitlements depend on the distress-resolution mechanism has been a perennial concern in bankruptcy policy. *See, e.g.*, Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987); Casey & Macey, *supra* note 35.

conducted foreclosure sales extinguish junior liens,[183] but do not shield buyers that are "mere continuations" of the seller from claims founded on successor liability.[184] Successor liability theories likewise survive a receiver's sale of assets on a going-concern basis, even if the sale order says otherwise.[185] State-law reorganization mechanisms thus resemble our "less aggressive" implementation of super-durability in their treatment of tort creditors. Put differently, our "less aggressive" proposal is a proposal to *undo* the bankruptcy-specific practice of extinguishing successor liability. Financial creditors might for that reason prefer state-law mechanisms to our "more aggressive" implementation. But the magnitude of the difference is uncertain and would have to be traded off against the procedural advantages of a bankruptcy forum. In short, it will be hard to escape some kind of super-durability rule if reorganization rather than liquidation is in the cards.

Piecemeal liquidations, by contrast, generally do extinguish successor liability. They prevent any one buyer of a debtor's assets from plausibly being understood as the debtor's "mere continuation."[186] Buyers in a liquidation therefore have no need to discount their offers, as they do in a going-concern sale. At the margin, a Chapter 11 norm of super-durability for tort claims should thus tip financial creditors toward Chapter 7 or another form of liquidation.[187] If, that is, a debtor's assets would be equally valuable sold piecemeal or as a going-concern, financial creditors would have reason to prefer and lobby for liquidation.

It is likely, however, that the magnitude of any dislocation will be small. Simple economics are the most important reason. The assets of viable businesses are typically worth much more sold intact than as scrap.[188] But financial creditors have an incentive to lobby for liquidation only if the expected proceeds from liquidation exceed those from a going-concern sale (or the value otherwise received in a reorganization). For most viable companies, that condition could be satisfied only if they tort claims were perceived to be very large.

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183. U.C.C. § 9-617(a)(3) (AM. LAW INST. & UNIF. LAW COMM'N 2010).

184. *See, e.g.*, Call Cent. Tech., Inc. v. Grand Adventures Tour & Travel Publ'g Corp., 635 F.3d 48, 52-55 (2d Cir. 2011) (reversing summary judgment for the buyer of assets in a properly conducted Article 9 sale, on the ground that buyer may be a "mere continuation").

185. *See, e.g.*, Teed v. Thomas & Betts Power Sols., L.L.C., 711 F.3d 763 (7th Cir. 2013).

186. Turner v. Bituminous Cas. Co., 244 N.W.2d 873, 883 (Mich. 1976).

187. *Cf.* Douglas G. Baird & Thomas H. Jackson, Kovacs *and Toxic Wastes in Bankruptcy*, 36 STAN. L. REV. 1199, 1202-03 (1984); *see also Teed*, 711 F.3d at 768-69 ("[A]n insolvent company, seeking to maximize its value, might decide not to sell itself as a going concern but instead to sell off its assets piecemeal, even if the company would be worth more as a going concern than as a pile of dismembered assets. In the latter case there would be as we said no successor liability, and successor liability depresses the going-concern value of the predecessor, so the insolvent company might be better off even though it was destroying value by not selling itself as a going concern.").

188. *See* LoPucki & Doherty, *supra* note 86, at 43-44.

Managerial freedom to choose a debtor's path is at its ebb in just such cases. Debtors can face immediate judicial second-guessing if they pursue a wasteful liquidation in bankruptcy. In extreme cases, junior creditors may seek to convert a Chapter 7 case to Chapter 11.[189] Bankruptcy judges would presumably be especially keen to offer relief in precisely the cases where financial creditors might be tempted to sacrifice aggregate value for individual priority. Debtors face less immediate scrutiny if they seek to wind up a business under state law, but the scrutiny comes. The directors of insolvent companies are liable to their creditors for waste.[190] To be sure, waste is not easy to prove. Judges are hesitant to use generic doctrines of corporate law to protect creditor interests.[191] But it is hard to imagine a stronger case than where it looks like the existence of large tort debts has motivated a board to dissipate value through an unnecessary liquidation.

On top of that, outside of bankruptcy, piecemeal liquidations do not always extinguish successor liability. Some courts have created a *product line* exception to the general rule of non-liability for successors. Under this exception, if the successor uses a product developed by the seller, and the product turns out to be deficient, the successor can be held liable for tort claims that can be tied to the use of the deficient product.[192] Versions of the product line exception are now used in California, New Jersey, New Mexico, New York, and Pennsylvania.[193] The product line exception is a judicial innovation.[194] Bankruptcy judges, too, could use their equitable powers to impose successor liability on whatever entity purchases assets that give rise to tort claims.

None of this is to say that a super-durability norm could be implemented without any strategic reaction. On the margin, such a norm would induce financial creditors in cases with large tort liabilities to avoid Chapter 11. But the costs of that effect could (a) occasionally be managed by bankruptcy judges, and (b) appear to be second-order.[195]

189. 11 U.S.C. § 706(b) (2018) ("On request of a party in interest and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 11 of this title at any time.").

190. *See, e.g.*, Quadrant Structured Prods. Co. v. Vertin, 115 A.3d 535 (Del. Ch. 2015).

191. Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 749-50 (2020).

192. *See* Ray v. Alad Corp., 560 P.2d 3, 5 (Cal. 1977).

193. *See New York Court Adopts "Product Line" Exception to Successor Corporate Liability*, FINDLAW (June 10, 2016), https://corporate.findlaw.com/litigation-disputes/new-york-court-adopts-product-line-exception-to-successor.html [https://perma.cc/HCF9-43ES].

194. *See id.*

195. We should also note that the Chapter 11 avoidance criticism applies with equal force to proposals for a statutory super-priority. If you like that idea, then Chapter 11 avoidance is no reason to dislike a conventional super-durability.

B. The Political Economy of Bankruptcy Courts

The other important objection is that the political economy of bankruptcy courts will prevent implementation of our approach however sound it may be in theory. The idea is that our approach will not in fact be implemented in cases where it matters. We take this objection seriously, but it misses the register of our argument and overestimates the stability of current practice.

Bankruptcy's liberal venue rule underlies a contentious literature about the political economy of Chapter 11.[196] A corporation may initiate bankruptcy in the judicial district in which it is incorporated, the district in which it conducts its principal business, or, crucially, in any district in which an affiliate's case is pending.[197] With minimal advance planning, then, businesses of any size can in effect choose from among the 94 judicial districts. In practice, most large companies file in one of only a very few districts, including Delaware and the Southern District of New York.

Commentators are divided on what to make of these facts. Some explain the dominance of a few districts as the product of a race to the bottom.[198] They argue that flexible venue, coupled with judges' natural and subtle—yet pervasive—interest in participating in important and interesting reorganizations, yields a perverse political economy.[199] In equilibrium, cases are predominantly filed in districts with local rules and procedures favorable to managers and others (especially senior creditors) who decide where to file—and all the more so if bankruptcy judges actively cater to the interests of these *case placers*. Others argue that competition for cases has yielded generally efficient practices, through a combination of judicial expertise and network effects.[200] On this view, the predictability of modern

196. For an early assessment of the terms of debate, see Barry E. Adler & Henry N. Butler, *On the "Delawarization of Bankruptcy" Debate*, 52 EMORY L.J. 1309 (2003).

197. 28 U.S.C. § 1408 (2018).

198. *Cf.* Cary, *supra* note 60.

199. *See* LYNN M. LOPUCKI, COURTING FAILURE (2005); Laura Napoli Coordes, *The Geography of Bankruptcy*, 68 VAND. L. REV. 381 (2015); Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967 (1999); Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231 (2001); Samir D. Parikh, *Modern Forum Shopping in Bankruptcy*, 46 CONN. L. REV. 159 (2013); Anthony Casey & Joshua C. Macey, *Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars*, EMORY BANKR. DEV. J. (2021) (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3789994 [https://perma.cc/SN93-8VK5].

200. *See* Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425 (2006); Marcus Cole, "*Delaware Is Not a State": Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845 (2002); Jared A. Ellias, *What Drives Bankruptcy Forum Shopping? Evidence from Market Data*, 47 J. LEGAL STUD. 119 (2018) (finding greater predictability of outcomes in Delaware and Southern District of New York, but no evidence of bias); Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW.

Chapter 11 practice, which is possible only if a few courts handle most of the complex reorganizations, attracts capital to distressed businesses and so (in expectation) may be to everyone's advantage.[201]

One need not have a general view of the venue debate, however, to sense that tort creditors might not fare well. For venue competition to yield an efficient result on a particular matter despite managers' unilateral power, a feedback mechanism of one kind or another is crucial. In other words, the managers who select venue must be forced to "pay" for their choices, and so internalize the costs of those choices on others. There are plausible mechanisms when it comes to financial creditors, who can take collateral, charge excess interest, or decline to lend altogether to distressed businesses who provide inadequate assurances about how bankruptcy, if necessary, will go. If the feedback mechanism is robust, then the "selected" venues will be those that pay heed to financial creditors' and managers' interests. Tort victims, by contrast, have no leverage and so in a competitive system will tend to be on the wrong side of discretionary calls. Super-durability strategies depend on judicial discretion. Therefore, the argument goes, super-durability is not part of a stable equilibrium.

We have three responses. First, the objection misses the register of our project. Our appeal is directly to bankruptcy judges' sense of what it means to judge well. We are saying that the right way to handle debtors with substantial tort claims is to cause those claims to persist through bankruptcy. It is no answer to such an argument to respond that corporate managers will not like it. To be sure, there are situations where a course of action is so plainly incentive incompatible, or so obviously depends on universal virtue, that it is useless to propose. But a super-durability strategy is nothing of the sort. Bankruptcy judges are first and foremost lawyers who have taken an oath to apply legal principles impartially. The bankruptcy bench consists of a relatively small group of people—350 at last count—who associate professionally and socially and share a culture. No one's career or well-being is on the line.

Second, and related, it is easy to overstate as a matter of fact the competitive pressure to disregard best practices that protect tort victims. The future-claimant trust is a case in point. A major problem in the asbestos cases in the 1980s was that not all who had been harmed by exposure had manifested symptoms by the time a producer's bankruptcy.[202] If all of the available assets were distributed to *existing* creditors as of the time of the bankruptcy, the so-called future claimants would recover nothing. The

U. L. REV. 1357 (2000); David A. Skeel, Jr., *What's So Bad About Delaware?*, 54 VAND. L. REV. 309 (2001); David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1 (1998).

201. *Cf.* Winter, *supra* note 60, at 284.

202. *See* 11 U.S.C. § 524(g) (2018); *In re* Fairbanks Co., 601 B.R. 831 (Bankr. N.D. Ga. 2019).

answer developed specifically for the asbestos bankruptcies—deposit assets in trust for the future claimants[203]—is sound in cases likely to see future claimants. But preserving assets for future claimants also diminishes the recoveries of current claimants, including financial creditors, shareholders, and managers. A theory of robust competition predicts that bankruptcy courts would therefore disfavor their use. To the contrary, however, future-claimant trusts have become a standard feature of practice in bankruptcy courts throughout the country.[204]

Third, the liberal venue rule itself may not last. Bills introduced in both houses of Congress in the last three years would curtail managers' ability to choose their bankruptcy court, requiring them instead to file in the judicial district of their principal place of business.[205] Attempts to alter bankruptcy venue have come and gone since the Bankruptcy Code was enacted in 1978. Recent attempts could of course likewise prove fruitless. But there is reason to think support for constraining managers is stronger now than in the past.[206] If venue choice is eliminated or even sharply restricted, then objections to our approach grounded in bankruptcy's political economy would be moot. Congress, it seems, is more likely to eliminate forum shopping than it is to give tort claimants a super-priority claim.

Conclusion

For decades, bankruptcy's tort problem has facilitated antisocial conduct. Bankruptcy has allowed debtors to pay financial creditors before sexual abuse victims, opioid addicts, environmental claimants, and wildfire casualties. Academic solutions that look elegant in theory have proven impossible to implement. This Article has shown that a durability norm is in many respects theoretically equivalent to the super-priority rule for which scholars have long advocated. Unlike a super-priority rule, however, bankruptcy judges could implement a super-durability norm without congressional action.

This is not to say that a super-durability norm is without costs. Uncertainty, asymmetric information, and debt overhang could prevent buyers from purchasing assets even when those assets could be put to productive use. As we have explained, however, there is reason to think that these problems are not intractable. Even a durability norm that blocked socially productive asset sales would not necessarily be fatal to our argument.

203. Listokin & Ayotte, *Protecting Future Claimants*, *supra* note 12, at 1435-36; Roe, *supra* note 12.

204. *See Fairbanks*, 601 B.R. 831.

205. H.R. 4421, 116th Cong. (2019); S. 2282, 115th Cong. (2018).

206. Organizations backing a change include the likes of the National Association of Attorneys General. *See* Bob Lawless, *Letter from 163 Bankruptcy Judges Backs Venue Reform*, CREDIT SLIPS (May 5, 2020), https://www.creditslips.org/creditslips/2020/05/letter-from-163-bankruptcy-judges-backs-venue-reform.html [https://perma.cc/92EZ-MZW3] (summarizing support to date).

Bankruptcy involves tradeoffs. By definition, an insolvent firm cannot honor all of its obligations. There is a real cost to preventing valuable assets from being put to productive use, but so too is it inefficient to allow firms to exploit the bankruptcy process to externalize social costs. In a world of tradeoffs, it is not obvious that the benefits of ensuring that socially valuable assets are put to productive use always outweighs the benefits of forcing firms to internalize the costs of socially harmful behavior.