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In Defense of Chapter 11 for Mass Torts

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Abstract. This Essay argues that bankruptcy proceedings are well-suited to resolving mass tort claims. Mass tort cases create a collective action problem that encourages claimants who are worried about available recoveries to race to the courthouse to collect ahead of others. This race can destroy going concern value and lead to the dismemberment of valuable firms. Coordination among them is difficult as each claimant seeks to maximize its own recoveries. These are the very collective action and hold-out problems that bankruptcy proceedings are designed to solve. As such, bankruptcy proceedings are appropriate means of resolving mass torts as long as they leave tort victims no worse off than they would have otherwise been. We further argue that legal innovations such as third-party releases and divisional mergers, which facilitate efficient bankruptcy proceedings and reduce holdout problems, should be welcomed as long as courts are attentive to the potential for abuse.

Of course, the bankruptcy process is not fully immune to abuse. For example, incumbent managers may have outsized bargaining leverage in bankruptcy or may take advantage of information asymmetries to push for reorganizations that divert value away from tort claimants. To control for such abuse, this Essay explores potential reforms aimed at ensuring that bankruptcy proceedings effectively mitigate collective action problems without disadvantaging tort victims as a class. Some of these reforms, such as giving tort claimants a priority claim, will sound familiar to bankruptcy scholars. Others, such as giving tort claimants a right to propose a plan of reorganization are more extreme. Because all these proposals have costs and

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benefits, our aim is not to endorse any one set of reforms; rather we emphasize that it is possible to address potential abuses through internal reforms that facilitate mass tort resolutions within the bankruptcy system without resorting to measures that prohibit or make such proceedings unnecessarily expensive.

INTRODUCTION

Between 2017 and 2022, several high-profile businesses and nonprofit firms initiated chapter 11 proceedings[1] to resolve multiple claims related to alleged sexual misconduct,[2] billions of dollars of opioid liability,[3] tens of thousands of claims involving the manufacture of allegedly carcinogenic products,[4] and hundreds of thousands of claims related to allegedly defective earplugs.[5] In all of these cases, the debtors employed controversial maneuvers to facilitate global resolution and to minimize the operational disruptions that can result from bankruptcy filings.[6] Most notorious among these maneuvers are the third-party release (a key feature in every mass tort

[1] Chapter 11 is the part of the United States Bankruptcy Code that addresses the reorganization and preservation of value for viable businesses. See DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 58–63 (Foundation Press eds., 7th ed. 2022).

[2] See Finding of Fact, Conclusions of Law, and Order Confirming the Modified Third Amended Joint Chapter 11 Plan of Reorganization Proposed by USA Gymnastics and the Additional Tort Claimants Committee of Sexual Abuse Survivors, In re USA Gymnastics, Case 18-09108, Doc. 1776, ¶ 2 (Dec. 16, 2021) (providing $380 million to settle allegations of sexual misconduct); The Associated Press, Boy Scouts sell off camps under financial strain from sex abuse lawsuits (June 4, 2022), https://perma.cc/LE8U-RU5F (describing $2.6 billion settlement to settle claims of sexual misconduct).

[3] See Jan Hoffman, Sacklers and Purdue Pharma Reach New Deal With States Over Opioids, NYTimes (Mar. 3, 2022), https://www.nytimes.com/2022/03/03/health/sacklers-purdue-oxycontin-settlement.html (describing Purdue settlement).

[4] See Dietrich Knauth, Bankruptcy judge will consider re-opening some J&J talc cases, Reuters (June 14, 2022), https://perma.cc/GT35-YNEJ (describing Johnson & Johnson's use of bankruptcy to settle claims that its baby powder contained carcinogenic talc). Three other large but less high-profile firms also initiated Chapter 11 proceedings in North Carolina to resolve potential asbestos liability. *See generally* In re Aldrich Pump LLC, 2021 WL 3729335 (Bankr. W.D.N.C. Aug. 23, 2021); In re DBMP LLC, 2021 WL 3552350 (Bankr. W.D.N.C. Aug. 23, 2021); In re Bestwall LLC, 605 B.R. 43 (Bankr. W.D.N.C. 2019). They were advised by the same law firm as Johnson & Johnson with regard to the filing and all used a similar structural device in preparing for the filing. The structure used in these cases, which involves a divisive merger under Texas law followed by a bankruptcy filing, has been pejoratively labeled the "Texas Two-step." See infra Part I.B.

[5] See Kate Marino, 3M unit's bankruptcy could put U.S. mass tort system on trial, Axios (Sep. 12, 2022), https://perma.cc/25ZV-YJZC.

[6] See, e.g., Casey Cep, Johnson & Johnson and a New War on Consumer Protection, THE NEWYORKER (Sept. 19, 2022), https://perma.cc/S6M4-CBNR.

bankruptcy) and the two-step bankruptcy (a recent innovation in asbestos cases, also known as the "Texas" two-step[7]).

While most bankruptcy courts have blessed the use of Chapter 11 to resolve mass torts claims, scholars,[8] policymakers,[9] and media commentators[10] have argued that bankruptcy proceedings provide an improper forum for resolving these

[7] "Texas" because it relies on Texas state law for its first step. See infra Part III.B. The label can cause some confusion. Notably, no two-step bankruptcy has been filed in a bankruptcy court in Texas. For ease of exposition and clarity, we will use the phrase "two-step bankruptcy."

[8] Sergio Campos & Samir D. Parikh, *Due Process Alignment in Mass Restructurings*, FORDHAM LAW REVIEW 3 (Forthcoming 2022) (arguing that bankruptcy does not provide sufficient due process protections and suggesting reforms); Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 YALE L.J. 960, 1004 (2022) ("Nonconsensual nondebtor release practice is illegitimate and unconstitutional substantive lawmaking by the federal courts."); Lindsey Simon, *Bankruptcy Grifters*, 130 YALE L.J. 1145, 1159 (2022) ("If left unchecked, bankruptcy can serve as an accelerant for the gravest due-process threats facing mass-tort victims."); Michael Francus, *Texas Two-Stepping Out of Bankruptcy*, 112 MICH. L. REV. 41, 42; Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 Tex. L. Rev. 841, 843 (2022); Samir D. Parikh, *Scarlet-Lettered Bankruptcy: A Public Benefit Proposal for Mass Tort Villiain*s, 82 NW. U. L. REV. 425, 430 (2022); Lindsey Simon, *The Settlement Trap*, 58 IND. L.J. 661 (2021) (describing "the process by which bankruptcy law ensnares payment of mass tort settlements."); Melissa B. Jacoby, *Shocking Business Bankruptcy Law*, 131 YALE L.J. FORUM 409, 411 (2021); see also Samir D. Parikh, Mass Exploitation, 170 U. PA. L. REV. ONLINE 53, 57–59 (2022) (noting that "mass restructuring debtors are exploiting statutory loopholes to fashion an ex post, ad hoc resolution structure that seizes all of the Bankruptcy Code's benefits with few of the costs" and exploring potential policy responses).

[9] See, e.g., Nondebtor Release Prohibition Act of 2021, H.R. 4777, 117th Cong. (2021), https://perma.cc/BZJ6-56RT. See also Abusing Chapter 11: Corporate Efforts to Side-Step Accountability Through Bankruptcy, Hearing Before the Subcomm. on Fed. Ct.s, Oversight, Agency Action, and Fed. Rights, 117th Cong. (2022), https://perma.cc/U67S-X6DR.

[10] See Mike Spector and Dan Levine, Special Report: Inside J&J's secret plan to cap litigation payouts to cancer victims, REUTERS (Feb. 4, 2022), https://perma.cc/VX75-MY64; Jonathan Randles, Profitable Companies Enlist Bankruptcy Courts to Sidestep Cancer Trials, WALL STREET JOURNAL (Feb. 8, 2022), https://www.wsj.com/articles/profitable-companies-enlist-bankruptcy-courts-to-sidestep-cancer-trials-11644319800. See also All Things Considered, Companies are increasingly using a legal strategy that prevents future lawsuits, NPR (Feb. 9, 2022), https://perma.cc/W4YC-LA33.

cases. Critics have taken special aim at the use of the third-party release[11] and the two-step bankruptcy.[12]

In this Essay, we argue that Chapter 11 proceedings provide an appropriate and often superior forum in which to resolve mass tort claims. We further argue that legal innovations such as the two-step bankruptcy and the third-party release can reduce bankruptcy costs and preserve value for all claimants. As a result, these maneuvers and others like them should be welcomed as long as courts are attentive to the potential for opportunistic abuse.

Bankruptcy law resolves the collective action problem that arises when creditors pursuing their claims in a variety of separate proceedings.[13] When creditors acting alone worry about not recovering the full value of their debt, they race to the courthouse—or courthouses—to collect what they are owed.[14]

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[11] See, e.g., Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. 102, 105 (2022) (arguing that because of third-party releases "[t]he single most important question in the most socially important Chapter 11 case in history could readily have been determined through a process that does not comport with basic notions of due process"). See also Abusing Chapter 11: Corporate Efforts to Side-Step Accountability Through Bankruptcy, Hearing Before the Subcomm. on Fed. Ct.s, Oversight, Agency Action, and Fed. Rights, 117th Cong. (2022), https://perma.cc/U67S-X6DR ("The third parties . . . . who get released as part of confirmation, get off the hook while the person who was injured or who contracted cancer has lost the ability to prove the claim against the third parties and recover from them.").

[12] See, e.g., Michael A. Francus, Texas Two-Stepping Out of Bankruptcy, 120 MICH. L. REV. 38, 43 (2022); Jamie Smyth, 'Texas two-step': the US move letting corporations off the hook, FINANCIAL TIMES (Oct. 24, 2022), https://www.ft.com/content/82ee5808-716e-47ae-acfb-2aba4b3d1502; Dick Durbin, Press Release, Durbin Highlights Johnson & Johnson's Shameful 'Texas Two-Step' Maneuver On Senate Floor (Feb. 22, 2022) https://perma.cc/2Q9S-HVS8 (calling the Texas two-step a "get-out-of-jail-free card" for corporations).

[13] One of us (Casey) has argued elsewhere that the purpose of corporate bankruptcy goes *beyond* solving the collective action problem. Anthony J. Casey, Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy, 120 Col. L. Rev. 1709, 1720 (2020) (noting that corporate bankruptcy is "much more" than a narrow collective action problem). But that view of bankruptcy of course includes within its scope the classic and until now uncontroversial view that corporate bankruptcy solves collective action problems among claimants.

[14] THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7 (Harvard Univ. Press eds., 1986); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 859-71 (1982); Douglas G. Baird, *A World Without*

The result is the destruction of value and potential dismemberment of viable firms. This leaves all claimants and stakeholders worse off. The Bankruptcy Code's core provisions[15]—the automatic stay, priority rules, prohibitions on fraudulent transfers, preference rules, and treatment of unpaid claims—are all designed to address these problems. This point has never been controversial.[16]

Mass tort cases present this exact collective action problem. When a firm is unable to pay all its tort claims, claimants who file early, or who find themselves before a sympathetic jury, or whose injuries happen to manifest quickly, may receive a large payout. Late claimants risk of being left with nothing if the firm's resources are depleted. Further, the costs of a decentralized, lengthy resolution of mass torts claims over time can be large and value-destructive for all stakeholders.

In our view, Chapter 11 proceedings mitigate these problems and provide an appropriate and often superior forum in which to resolve mass tort claims. Despite the rhetoric surrounding recent cases, the bankruptcy community has for decades recognized the resolution of mass tort claims has been a widely accepted core function of bankruptcy courts for decades. And for good reason: Chapter 11 provides tools for dealing with holdouts and future claimants that are unavailable in conventional class action or multi-district litigation proceedings.

Moreover, bankruptcy tools that facilitate efficient, lower-cost resolution should be welcomed. The two-step bankruptcy and the third-party release are such tools as long as courts guard against opportunistic abuse. Properly used, the third-party release prevents holdout behavior and incentivizes perpetrators of corporate misconduct to disclose their role in the company and to contribute assets to the bankruptcy estate. Similarly, the two-step bankruptcy allows a firm to quarantine mass tort liabilities from operations facilitating resolution in a single, streamlined bankruptcy proceeding without involving all non-tort counterparties. These maneuvers thus further the Code's

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Bankruptcy, 50 LAW & CONTEMP. PROBS. 183, 184 (1987) ("[T]he self-interest of creditors leads to a collective action problem, and a legal mechanism is needed to ensure that the self-interest of individuals does not run counter to the interests of the group.").

[15] 11 U.S.C. § 362; 11 U.S.C. § 1129; 11 U.S.C. § 507.

[16] Plenty have people have argued that corporate bankruptcy law can do more than solve collective action problems among claimants. But few if any have argued that bankruptcy law does not in the very least address this problem.

purpose by providing a single forum in which to efficiently and fully resolve the firm's mass tort liabilities.[18]

Of course, debtors and managers can abuse the third-party release and the two-step bankruptcy. But given their potential to benefit all claimants, they should not be altogether prohibited. Instead, because the potential for abuse is identifiable, targeted procedures and reforms can mitigate it.

To control for such abuse, courts should ensure that mass tort bankruptcy proceedings do in fact mitigate collective action problems and that tort claimants as a class are not made worse off by the bankruptcy.

To that end, courts should be aggressive in demanding disclosures regarding the released parties' roles in the firm's affairs, in requiring strong proof about the value of assets and liabilities, in policing fraudulent transfers and preventing managers from funneling assets to their preferred stakeholders, and in using warrants and other devices that align the incentives of debtors and tort claimants.

Perhaps a trickier issue is that unequal bargaining dynamics and information asymmetries open the door for may allow managers to use the reorganization process to take advantage of tort claimants.[19] With full control of the bankruptcy proceeding, managers can pressure tort claimants with they take-it-or-leave it offers. They may also have private information about asset and claim values. If managers expect assets to increase in value, they may push for a speedy reorganization that allows them to capture the future upside of the firm's most valuable assets. Conversely, they may give tort claimants future claims on assets that they know will turn out to be worth relatively little.

Though these are serious concerns, we think that they, too, are best be addressed through reforms to the bankruptcy process. To that end, we consider a menu of reforms that would inhibit insiders from taking advantage of their superior informational position. The potential reforms could include eliminating the debtor in possession's exclusive right to propose a plan of reorganization, limiting the scope of injunctions that

[18] Anthony J. Casey and Aziz Z. Huq, The Article III Problem in Bankruptcy, 82 U. Chi. L. Rev. 1155, 1198 (2015) ("Some matters must be litigated before a centralized tribunal because a critical benefit of bankruptcy derives from the procedural aggregation of claims into a single forum as a way to mitigate perverse and destructive collective action problems").

[19] This appears to be an issue both inside and outside of bankruptcy.

courts can grant, appointing independent directors or those that represent the interest of tort claimants, or replacing management with a trustee or some other similar custodian.

Some of these reforms are extreme and would impose considerable costs. For example, replacing incumbent managers may destroy value if the new managers lack requisite experience and knowledge about the firm they must now operate. Because it is difficult to weigh the benefits of some of these bankruptcy reforms against their costs, we urge reformers to exercise caution when amending the Bankruptcy Code to reduce the ability of managers to opportunistically leverage information asymmetries. Still, to the extent that reformers worry that incumbent managers will use their insider knowledge about the firm to exploit tort claimants, one solution is to fire C-suite executives and replace them with managers who owe a fiduciary duty to tort claimants. Our main point is that despite the potential for abuse in mass tort cases, tailored solutions remedies retain bankruptcy law's tools to facilitate a quick and efficient reorganization.

This Essay presents our argument in four parts. Part I provides background and describes the controversies surrounding mass tort bankruptcies, third-party releases, and two-step bankruptcies. Part II explains why bankruptcy proceedings provide an appropriate forum for resolving mass tort claims. It argues that without the option of Chapter 11 proceedings, tort victims in several recent high-profile cases would have received less compensation; the compensation would have been unfairly distributed; and the administrative costs of resolving their claims would have been higher. Part III compares the benefits and drawbacks aspects of maneuvers like the third-party release and the two-step bankruptcy and shows that they are valuable tools in facilitating Chapter 11 resolution of mass torts. Part IV argues that judicial oversight can mitigate the potential for abuse of bankruptcy proceedings and related maneuvers, and describes bankruptcy reforms that might enhance that oversight.

I. Bankruptcy's "New" Battleground: Chapter 11 Resolution of Mass Torts, the Third-Party Release, and the Two-Step Bankruptcy

While mass tort bankruptcies have existed for decades,[21] the topic has garnered new attention in the wake of recent

[21] And the idea of aggregating claims into a bankruptcy proceeding

filings, especially that of Purdue Pharma (Purdue).[22] Judicial authorization of nonconsensual third-party releases and two-step bankruptcies has led to vocal media and academic criticism,[23] and prompted Congress to propose legislation addressing bankruptcy abuses.[24] The not-so-subtly named at "SACKLER Act" (short for "Stop shielding Assets from Corporate Known Liability by Eliminating non-debtor Releases Act") made director reference to Purdue's owners, the Sackler family.

Similar objections have surfaced in response to the bankruptcies involving Johnson & Johnson, 3M, the Boy Scouts, USA Gymnastics, and other large businesses facing potentially massive tort liability. The common thread in these cases is the use of Chapter 11 proceedings to reach a global resolution of mass tort claims. The common criticisms are that Chapter 11 proceedings provide a poor mechanism for resolving mass tort claims and that maneuvers such as the third-party release and the two-step bankruptcy allow wrongdoers to avoid mass tort liability and personal accountability for their misconduct.[25]

This Part briefly summarizes the arguments for and against Chapter 11 resolution of mass tort claims generally, then describes the third-party release and the two-step bankruptcy,

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is not new. See Alan N. Resnick, *Bankruptcy As A Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. Pa. L. Rev. 2045 (2000); Troy A. McKenzie, *Toward A Bankruptcy Model for Nonclass Aggregate Litigation*, 87 N.Y.U. L. Rev. 960, 1000 (2012); see also Alexandra D. Lahav, The Continuum of Aggregation, 2019 Ga. L. Rev. 1 (2019)

[22] See discussion of Purdue Pharma below __

[23] See, e.g., Oregon Department of Justice, AG Rosenblum Statement on Purdue Pharma's Bankruptcy Plan (Sept. 1, 2021), https://perma.cc/94G7-F8JK (calling the "decision by Judge Drain to move forward with Purdue's bankruptcy plan . . . . extremely disappointing."); Phil Helsel, States vow to fight Purdue Pharma bankruptcy plan that shields Sacklers from opioid lawsuits, NBC NEWS (Sept. 1, 2021), ("This decision is a slap in the face to the millions of suffering and grieving Americans who have lost their lives and loved ones due to the Sacklers calculated and craven pursuit of opioid profits."). Subsequently, the district court reversed the bankruptcy court's approval of the plan, and the case now sits before the Second Circuit on subsequent appeal. *See In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021), *certificate of appealability granted*, 2022 WL 121393 (S.D.N.Y. Jan. 7, 2022).

[24] H.R. 2096, 117th Cong. (2021).

[25] See, e.g., Lindsey Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154, 1171 (2022) (raising concerns about "an emerging pattern of bankruptcy grifters who exploit nondebtor releases to obtain the benefits afforded to Chapter 11 debtors while avoiding the many accompanying obligations."); Smyth, *supra* note 12.

and finally uses the example of Johnson & Johnson to show how these dynamics can play out.

a. Bankruptcy as the New Multidistrict Litigation

For years, scholars and policymakers have expressed concern that multidistrict litigation (MDL) is a suboptimal way of resolving mass tort liability.[36]Procedural limitations can make resolution slow and costly.[37] Holdouts can disrupt the entire settlement.[38] The prospect of future claimants who will not be bound by the MDL results, make it impossible to reach full resolution. Judges may be unfamiliar with the law they are applying.[39] Procedural rules are applied inconsistently.[40] While MDL has vocal defenders,[41] even the most optimistic recognize its limitations.[42]

Regardless of whether—or why—MDL is failing to provide an acceptable venue in which to resolve mass tort claims, recent high-profile bankruptcy filings suggest that the

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[36] Edward F. Sherman, Aggregate Disposition of Related Cases: The Policy Issues, 10 REV. LITIG. 231, 234 (1991); Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. 447, 454 (2022); *but see* Howard M. Erichson & Benjamin C. Zipursky, *Consent Versus Closure*, 96 CORNELL L. REV. 265, 270 (2011) (arguing that MDL "creates the perfect conditions for an aggregate settlement"); Lahav supra note __ at 3 ("The use of bankruptcy to resolve aggregated claims was a response to the failure of both MDL and the class action in resolving some types of aggregate litigation, especially asbestos litigation in the 1980s-90s.").

[37] See Linda S. Mullenix, *Aggregate Litigation and the Death of Democratic Dispute Resolution*, 107 NW. U. L. REV. 511, 541 (2013) ("[A]ttorneys involved in aggregate litigation devised a means for disposing of large-scale litigation unburdened by exacting judicial scrutiny or jurisprudential constraints conferred by the class action rule."); Martin H. Redish & Julie M. Karaba, O*ne Size Doesn't Fit All: Multidistrict Litigation, Due Process, and the Dangers of Procedural Collectivism*, 95 B.U. L. REV. 109, 111 (2015) ("The substantive rights of [MDL] litigants are adjudicated collectively without any possibility of a transparent, adversary adjudication of whether . . . the interests of the individual claimants will be fully protected by those parties and attorneys representing their interests . . . .").

[38] See FED. R. OF CIV. PROC. 23(b)(1)-(3); Charles Silver & Geoffrey P. Miller, *The Quasi- Class Action Method of Managing Multi-District Litigations: Problems and a Proposal*, 63 VAND. L. REV. 107, 124 (2010).

[39] *See id* at 116.

[40] *See id*.

[41] *See, e.g.*, Erichson & Zipursky, *supra* note 3636, at 270.

[42] *See, e.g.*, Elizabeth Chamblee Burch, *Judging Multidistrict Litigation*, 90 N.Y.U. L. REV. 71, 84–118 (2015).

growing attractiveness of bankruptcy as an alternative to MDL is growing.[43] Across numerous industries, large businesses have initiated Chapter 11 bankruptcy proceedings to resolve mass tort claims. As noted above, these bankruptcies almost always involve the use of third-party releases and in recent years have a handful have used the two-step bankruptcy.

In response to these developments, scholars and policymakers have expressed skepticism that bankruptcy should offer an acceptable alternative to MDL for resolving mass tort claims.[44] They argue that corporations take advantage of the automatic stay and other court-ordered injunctions to delay paying tort claimants, that appellate review is too limited, that venue shopping allows debtors to pick sympathetic judges, and that bankruptcy fails to address the dignitary issues raised by mass tort claims.[45]

The bankruptcy process for tort claimants is not perfect. To encourage corporations to internalize the social costs of their behavior, perhaps it is possible that the Bankruptcy Code should give priority to tort claimants and strengthen fraudulent transfer law.[46] If the Bankruptcy Code's liberal venue rules allow corporations to pick judges who are unsympathetic to tort claimants—about which the evidence is mixed[47]—then maybe

[43] *See* Simon, *supra* note 35, at 1157.

[44] Another way to conceive of bankruptcy and MDL (and class actions) is not as alternatives but as different forms the aggregated litigation. In on one the best analyses of different forms of aggregate litigation, Alexandra Lahav makes this point. See Lahav, supra note __ at 16 ("Understanding the class action, MDL, and bankruptcy as different forms of the same fundamental thing, rather than as separate spheres, is both an important intellectual contribution and one with a real practical payoff."). We agree with this characterization. Our primary goal is to show that the bankruptcy form provides features that are especially well suited for the task at hand.

[45] *See* Levitin, *supra* note 11, at 1116–50.; see also House Judiciary Subcommittee Testimony from Georgetown University Law Center Professor Levitin (Jul. 28, 2021). ("Bankruptcy law has never dealt well with questions of moral justice—it is fundamentally a financial process that reduces all manner of obligation to cold, hard dollars, which are then allocated according to the Bankruptcy Code's priority structure. This financial logic has an unavoidable mismatch with the dignitary and expressive justice goals of tort law.").

[46] *See* Joshua C. Macey, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 921 (2019).

[47] *See* Anthony J. Casey & Joshua C. Macey, *Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars*, 37 EMORY BANKR. DEV. J 436, 438 (2021).

Congress should reduce judicial discretion or amend the Bankruptcy Code's venue rules.

But recent critics of the Chapter 11 bankruptcy system further argue that bankruptcy is fundamentally ill-equipped to handle mass tort claims, and taken particular aim at the two maneuvers that debtors use to do so. We turn now to those maneuvers.

b. The Third-Party Release and the Two-Step Bankruptcy

While third-party releases have existed for decades,[48] they have recently gained increased attention because of their central role in mass tort bankruptcies. In a nonconsensual third-party release, a court issues an order prohibiting parties with claims against the debtor from pursuing related claims against other parties who have not filed for bankruptcy, such as the debtor's managers, owners, and insurers. Even though most claimants subject to the release accept vote in favor of the order, the release is often classified as nonconsensual because ***some*** of the claimants object—a release is only considered consensual if it earns approval from 100% of claimants.[49]

The two-step bankruptcy, a recent innovation, is more complicated. In the first step, a firm splits itself into two legal entities and assigns its tort liabilities to the first entity and its assets and operations to the second. In step two, the first entity (holding the tort liabilities), and only that entity, initiates Chapter 11 proceedings. The key feature of this structure is the quarantine of the bankruptcy proceeding, leaving unaffected the operations located in the second entity.

[48] *See* Dorothy Coco, *Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Contract and Due Process Law*, 88 FORDHAM L. REV. 231, 234-42 (2019) (summarizing case law and identifying uses of third-party releases as early as 1985).

[49] This point is worth emphasizing. The release is nonconsensual because ***some*** claimants object and vote against it. To be clear, a key protective feature in third-party release cases involving mass torts is that a supermajority of the class of claimants must vote in favor of the release. *See infra* note 62 and accompanying text. For example, in the Purdue bankruptcy over 96% of the class of tort claimants voted in favor of the settlement. *See supra* note 30. A consensual release would require 100% approval by claimants. Even consensual releases are sometimes criticized, but for mass torts our focus will be on releases that receive less than 100% support and are therefore "nonconsensual." For the remainder of this Essay, our discussion of third-party releases will refer to nonconsensual releases unless otherwise specified.

To get into the legal weeds a little, the initial entity split occurs via a state law transaction known as a divisional merger.[51] The divisional merger is a state law transaction. To date, all four debtors initiating large two-step bankruptcies[52] have relied on Texas corporate law[53] for the authority to complete the transaction (hence the name "Texas Two-Step").[54]

We turn now to the Purdue and Johnson & Johnson cases to demonstrate what is at stake and how these dynamics play out.

i. Purdue

Opposition to mass tort bankruptcies reached a fever pitch in response to the Chapter 11 bankruptcy of Purdue Pharma (Purdue). Prior to bankruptcy, Purdue had been owned and operated by members of the Sackler family and was the originator and manufacturer of the highly addictive pain medication OxyContin, which has been linked to addiction. Court filings show that members of the Sackler family earned at least $10 billion from the drug.[64] Victim testimony acutely demonstrated the enormous personal devastation caused by the

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[51] The relevant state law defines a merger to include what would seem to be the opposite of a merger—the splitting of a business entity into two or more business entities. TEX. BUS. ORG. CODE § 10.003.

[52] In re Aldrich Pump LLC, (Bankr. W.D.N.C.); In re DBMP LLC, (Bankr. W.D.N.C.*)*; In re Bestwall LLC, (Bankr. W.D.N.C.); LTL

[53] TEX. BUS. ORG. CODE § 10.003. *See also* Written Testimony of David A. Skeel, Jr., Before the Subcommittee on Federal Courts, Oversight, Agency Action and Federal Rights Senate Committee on the Judiciary, United States Senate (Feb. 8, 2022), https://perma.cc/5RTN-8AB4.

[54] Divisional mergers are not unique to Texas. Delaware, Arizona, and Pennsylvania also authorize them. *See* Donald F. Parsons, Jr., Jason Russell, & Koah Doud, *Seventy-Five Years Covering the Rise of Alternative Entities*, 75 Bus. Law. 2467, 2485 n.144 (2020) (identifying DLLCA § 18-217 (allowing divisive mergers for LLCs); ARIZ. REV. STAT. §29-2601 (allowing divisions of domestic entities); 15 PA. CONS. STAT. § 361 (allowing divisions of domestic entities)). But the Texas divisional merger statute has proven more attractive than its Delaware counterpart, perhaps because it is significantly broader. Whereas Delaware limits divisional mergers to LLCs, the Texas Business Organization Code applies to any "domestic entity." *See* TEX. BUS. ORG. CODE § 10.003.

[64] *See* Hearing Before the Comm. On Oversight and Reform, U.S. House of Rep., 117th Congr. (Dec. 17, 2020), https://perma.cc/4UVM-BUWK ("The Sackler family has profited enormously from the OxyContin business. Since bringing this painkiller to market, the family has withdrawn more than $10 billion from the company.").

opioid crisis, which the Sacklers furthered and personally profited from.[65]

After years of litigation related to Purdue's role in contributing to the opioid crisis through aggressive marketing of OxyContin, Purdue initiated Chapter 11 proceedings to resolve the tens of thousands of claims that it faced. Fueling the controversy was the deal that the Sacklers negotiated as part of the bankruptcy plan. The bankruptcy judge confirmed a plan that released of all claims that any parties had against the Sacklers for their role in owning and managing Purdue.[66] In exchange, the Sacklers agreed to contribute $4.325 billion to a settlement trust for the benefit of those with claims against Purdue and the Sacklers.[67] (During subsequent appeals, the Sacklers increased the contribution to approximately $6 billion

[65] For example, a father who lost his son to an OxyContin overdose wrote a letter to Congress calling Purdue's bankruptcy a "SCAM because its main purpose is only to gain the Sacklers immunity. . . . [T]o have the Sacklers pay only a small percentage of what they made pushing OXY's would be a crime in itself." Edward J. Bisch, Letter to House Committee on Oversight and Reform, Dec. 8, 2020, https://perma.cc/JCA6-32SW. *See also* Beth Macy, *The Four Ordinary People Who Took on Big Pharma*, NYTIMES (July 20, 2019), https://www.nytimes.com/2019/07/20/opinion/sunday/oxycontin-purdue-sacklers.html.

[66] As the proposed plan put it, "the Shareholder Released Parties . . . shall be conclusively, absolutely, unconditionally, irrevocably, fully, finally, forever, and permanently released . . . from any and all Causes of Action…based on or relating to, or in any manner arising from, in whole or in part (i) the Debtors… (ii) the Estates or (iii) the Chapter 11 Cases . . . as to which any conduct, omission or liability of any Debtor or any Estate is the legal cause or is otherwise a legally relevant factor." *See* Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors at §10.7(b), at *126, In re Purdue Pharma L.P., No. 19-23649, Doc. 3726 (Bankr. S.D.N.Y. Sept. 2, 2021).

[67] *See id.* at §§ 1.1, 5.6 and 10.7. The Sacklers later increased their contribution to over $6 billion while appeals were pending in order to convince holdout states to drop their objections to the third-party releases. The Sacklers' willingness to increase their contribution has led some scholars to claim that tort claimants would be better off if third-party releases were prohibited. *See* Levitin, *Purdue's Poison Pill*, supra note 11, at 1090. Parts III and IV explain why that argument is incorrect. The debtors' ability to extract an increased contribution highlights the value of third-party releases. Given the legal uncertainty about those releases in any given court, the exact numbers that parties bargain to will vary. If releases are upheld with more legal certainty, one should expect parties like the Sacklers to pay more (not less) for those releases. Indeed, it is unsurprising that the amount increased as more parties agreed to drop their objections on appeal.

in further attempts to reach settlement.) Still, some victims objected to this deal arguing that members of the Sackler family had not personally filed for bankruptcy.

The deal was put to the victims for a vote as part of the bankruptcy plan of reorganization. Indeed, when resolving with mass tort claims, third-party release deals require require approval by a supermajority of victims. The Sackler the deal was approved by an overwhelming majority, but it was not unanimous. [68] A small number of those with potential claims against the Sacklers dissented setting up the question of whether their claims against the Sacklers could be released without their consent.

Critics claimed that the Sacklers were buying their way out of responsibility and that the bankruptcy court, by prohibiting additional lawsuits, was robbing the victims of their day in court. The bankruptcy court, consistent with our

[68] Most claimants, including over 96% of personal injury claimants, voted in favor of the plan. In re Purdue Pharma, L.P., 635 B.R. 26, 71 (S.D.N.Y. 2021). The case actually set the record for the number votes cast. Id. ("Some 120,000 votes were cast on the Plan – a number far exceeding the voting in any other bankruptcy case."). These voting numbers should give observers great confidence in the fairness of the settlement.

As Adam Levitin pointed out in the context of third party releases in the Dow Corning mass tort bankruptcy, "[N]o one can credibly claim that the settlement was the result of an unfair process. It was the product of lengthy, mediated negotiations and was supported by 94.1% of the personal injury claimants who voted on it, and ultimately approved by the bankruptcy court and upheld by the 6th Circuit Court of Appeals." Adam Levitin, *Elizabeth Warren & the Dow Corning Bankruptcy: Nothing to See*, Credit Slips available at https://www.creditslips.org/creditslips/2019/07/elizabeth-warren-the-dow-corning-bankruptcy-nothing-to-see.html.

Levitin went on to argue in favor of third party releases:

> The whole point of bankruptcy is to find the fairest deal possible for everyone involved, and then limit liability going forward to the extent possible. This is because preserving companies as going-concerns is often better than selling them off for parts. In this case, the parties arrived at an agreement that limited Dow Chemical's future liability in exchange for capitalizing a multi-billion dollar trust to pay out victims well into the future. That was good enough for the overwhelming majority of the people with personal injury claims who voted on the plan.

Id. Levitin has since changed his view on third party releases. Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 Tex. L. Rev. 841 (2022).

We believe he had it right the first time.

arguments below,[70] viewed the situation differently. It approved the deal, suggesting that the releases and the bankruptcy plan would achieve the best, most meaningful economic recovery for the overwhelming majority of victims.

Notably, the case is ongoing. The district court reversed the bankruptcy court's confirmation of the plan holding that nonconsensual third-party releases were not permitted. The debtor appealed that ruling and the case awaits decision from the United States Court of Appeals for the Second Circuit.

ii. Johnson & Johnson and the LTL Bankruptcy

Johnson & Johnson ("J&J") and its subsidiary affiliates face nearly 40,000 claims filed for allegedly manufacturing baby powder containing carcinogenic talc. They expect at least tens of thousands more to come. J&J, the parent company, operates subsidiaries in various industries. Relevant here, one of J&J's subsidiaries, Johnson & Johnson Consumer Inc. (JJCI), manufactures and sells baby powder. JJCI (which has existed in various forms since 1979) is the most obvious defendant in baby powder cases, although plaintiffs have brought suit against both JJCI and J&J.

JJCI has an estimated value of $61 billion. That seems like a lot, but if a significant number these cases prevail, it may not be enough to pay all of the claimants. If that happens, those who win the race and get to a successful verdict first will be paid and those who come later will not.

The cases tried so far have met with mixed success, some resulting in no liability and others resulting in multi-billion-dollar verdicts. The per plaintiff awards have ranged from zero to hundreds of millions. Thus, a claimant proceeding individually, might expect a small chance of receiving a huge payout. Even if only a fraction of JJCI's claimants received payouts in the tens-of-millions range, JJCI would quickly experience financial distress that would leave it unable to compensate other tort claimants, fund its other operations (including making Tylenol, Listerine, Band Aids, Aveeno, Neutrogena), and unable to pay its tens of thousands of empoylees.

For example, imagine a total of 70,000 claims ultimately surface. Now assume only 10% of those are successful. And that all successful cases result in damages of $10 million. With those assumptions, all the assets of JJCI are wiped out before we even

[70] See below __

take legal fees into account. If 1% resulted in $100 million verdicts, that would also wipe JJCI out.

Of course, no one knows yet what the outcomes will be for these cases. And the history of this cases and MDL litigation in general suggest the results will be highly varied, with some victims getting nothing and others getting hundreds of millions. And it would take just a few mega verdicts to render JJCI insolvent, leaving nothing for the remaining claimants or anyone else.

Without the ability to file for bankruptcy and use third-party releases to reach a global settlement, the company worried that it would be dragged into years of litigation that would ultimately divert value from tort claimants (as well as other stakeholders) to litigation professionals. Even if none of the claims result in large awards, the litigation costs alone will run into the billions of dollars.[72]

And these case presented one additional thorny problem. There are tens of thousands of future victims who cannot be identified today, because their illnesses have not yet manifested themselves. Some of these claimants won't know about their injury for decades. Thus, even with an MDL settlement with all existing claimants, JJCI would still be facing years of litigation.

Bankruptcy proceedings—especially those that allow for third party releases, the appointment of a future victims representative, and global settlement—can provide a way for companies like J&J and JJCI to resolve mass tort claims current and future.

But bankruptcy proceedings are costly and disruptive for large operating companies. A bankruptcy for J&J or even for JJCI would be massively complicated and expensive. A JJCI bankruptcy would rank in the top ten largest of all time. A J&J bankruptcy would rank in the top three. If JJCI had filed, The proceedings in would have dragged JJCI's operations, and its tens of thousands of employees, and all of its counterparties into the court proceedings. It is not trivial task to manage the manufacturing operations of brands of such as Tylenol, Listerine, Band Aids, Aveeno, and Neutrogena under the oversight of a bankruptcy proceeding and subject to the potential objections of all counterparties. So JJCI thus needed a mechanism to separate its operations from its liabilities.

[72] As of the filing date in October of 2021, litigation costs were approaching $1 billion, with a run monthly run rate of $10 to 20 million. See In Re LTL (3d Cir) at 21.

That's where the divisional merger comes in and the two-step bankruptcy come in.[73] In that transaction JJCI (now "Old JJCI") split itself into two corporate entities. The first, New JJCI, assumed Old JJCI's assets and continued to manufacture and sell consumer goods. The second, LTL Management (LTL), filed for bankruptcy to resolve its tort obligations. At the same time as the divisional merger, these entities entered into a funding agreement. This agreement provided that New JJCI would fund LTL's talc liability up to the greater of (a) the value of Old JJCI's enterprise value at the time of the divisional merger or the value of (b) New JJCI at the time of the payment of funds.[74]

Thus, Old JJCI was in fact worth \$61 billion, that set a floor on the available funds. New JJCI must accordingly make at least \$61 billion available to fund any talc liabilities. But the agreement also provides that if New JJCI increases in value and ends up worth more than \$61 billion when the funding becomes due, that higher number is used. To be clear, these numbers set available funds to cover talc liabilities, which are still unknown. If the liabilities end up totaling \$10 billion, then the funding agreement requires New JJCI to provide \$10 billion in funding.

Further, J&J (the parent) guaranteed the agreement. That meant that if the assets of New JJCI went down in value, J&J would make up the difference so that \$61 billion in funds would still be available.

It is difficult to see how the divisional merger harms the class of tort claimants. Before the divisional merger, they had claims against Old JJCI, which is estimated to be worth no more than \$61 billion. After the divisional merger they had claims against LTL, backed by the assets of New JJCI (holding the same assets as Old JJCI had) and J&J. That backing was worth *at least* \$61 billion. Thus, the economic effect on claimants appears to have been positive. They got a stronger guaranty of payment than they had before the divisional merger.

Indeed, in a particularly ironic judicial ruling, the Third Circuit Court of Appeals dismissed the LTL bankruptcy for lack

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[73] Just prior to initiating the divisional merger, J&J had attempted to achieve global settlement by offering to contribute to the bankruptcy fund of Imerys, its supplier, in exchange for third-party releases. See In Re LTL (3d Cir.) When that fell through, J&J began plans for the two-step bankruptcy of LTL.

[74] *See* John K. Kim First Day Declaration, In re LTL Management LLC, Case No. 21-30589, Doc. 5, ¶ 27 (Oct. 14, 2021) ("[T]he Funding Agreement requires New JJCI and J&J to, up to the full value of New JJCI, fund amounts necessary (a) to satisfy the Debtor's talc-related liabilities at any time when there is no bankruptcy case and (b) in the event of a chapter 11 filing, to provide the funding for a trust").

of good faith because the funding agreement provided the claimants with *too* much funding.[75] Given the virtual certainty of at least $61 billion in available funding, the court found that LTL was likely to pay all claimants in full and so was not in financial distress—at least not until it becomes clear that liabilities will exceed $61 billion.[76]

Notably the court said nothing about whether two-step bankruptcies, divisional mergers, or third-party releases were or were not appropriate. It held simply that the bankruptcy system was off limits to a debtor if there was enough uncertainty about whether financial distress was looming in the distance.[77]

Despite the presence of similar funding agreements in every two-step bankruptcy, divisional mergers have raised concerns that corporations are manipulating the bankruptcy process to disadvantage tort claimants.[78] Michael Francus, for example, has criticized divisional mergers for making it difficult for tort claimants to "sue the out-of-bankruptcy, asset-rich AssetCo for recompense."[79] Adam Levitin has argued that "[t]he

[75] In re LTL Management (3rd Cir. 2023)

[76] This idea that financial distress requires a significant risk of insolvency is new. The United States Bankruptcy Code has never required a debtor to be insolvent. And if it does that would strip bankruptcy

[77] To note another irony, the Third Circuit ruling implies that the debtors bad faith increases with the likelihood that plaintiffs' claims are frivolous. If the court knew that plaintiffs' claims were valid, then the debtor would be financial distress and could opt into the less expensive bankruptcy process. But if the court thinks the claims will result in no liability, then the debtor will be relegated to the more expensive MDL process to prove that.

[78] *See* Francus, *supra* note 12, at 38 (arguing that J&J's use of the "'Texas Two-Step' . . . threatens the tort recovery of tens of thousands of talc claimants."); Samir D. Parikh, Mass Exploitation, 170 U. PA. L. REV. ONLINE 53, 58–59 (2022); Adam Levitin, The Texas Two-Step: The New Fad in Fraudulent Transfers, CREDIT SLIPS (July 19, 2021), https://perma.cc/HM64-LQW6.

[79] *See* Michael Francus, supra note 12, at 41. The inability to sue the non-debtors is not an automatic result of the divisional merger, but Francus correctly points out that all of these cases begin with the debtors requesting, and usually obtaining, an order enjoining those lawsuits. One notable exception is the Aearo bankruptcy. While it is not technically a two-step bankruptcy, the case has some similar features. In that case 3M Company's existing subsidiary Aearo assumed liabilities for mass torts involving military ear plugs. 3M then provided a funding agreement to pay those liabilities for Aearo, and Aearo subsequently filed for bankruptcy. Aearo then sought an injunction of lawsuits against 3M, whicht he bankruptcy court denied. The case is currently on appeal before the United States District Court for the Seventh Circuit.

tort victims find themselves creditors in the bankruptcy of BadCo and get bupkes, while the bankruptcy plan inevitably includes a release of all claims against GoodCo. Pretty nifty way to hinder, delay, or defraud creditors if it works, right?"[80] Both Francus and Levitin are concerned that divisional mergers result in inadequate recoveries for tort claimants. Note, however, that Francus is more concerned about debtors' ability to pair divisional mergers with third-party releases. He is worried that third-party releases will allow debtors to underfund the successor entity that takes on the company's tort liabilities while shielding its assets by placing them in a separate affiliate. And Francus validly raises that point with regard to LTL. While the case is currently at an early stage, if the Third Circuit ruling gets reversed and the bankruptcy moves forward, the question of third-party releases is certain to raise its head when LTL proposes a plan that includes non-debtor releases for J&J and New JJCI. This implicates the same issues that are in play in Purdue. To preview our analysis below, releases for J&J, like those the Sacklers, should be conditioned on a substantial payment for the benefit of the claimants.

We share Francus' concerns that releases and divisional merges might be abused. But, as we explain in Part II.C, that potential is best addressed by requiring adequate disclosure, ensuring that the claims are valued correctly, and requiring adequate funding agreements to deal with uncertainty.[81]

c. Bankruptcy-as-MDL-Skeptics

Scholars have expressed concern that bankruptcy cases like Purdue's and LTL's the related legal manuevers allow individuals and corporations to evade accountability for their misconduct[82] and to avoid the full costs of bankruptcy,[83] and that

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[80] See Levitin, *supra* note 78.

[81] We argue below that the issue is better understood as being about valuation and disclosure—not about whether the release should be allowed or prohibited. If the company provides adequate disclosure and provides a payment that is deemed adequate by the court and the majority claimants then it should be approved.

[82] See, e.g., Simon, supra note 35, at 1171 (raising concerns about "an emerging pattern of bankruptcy grifters who exploit nondebtor releases to obtain the benefits afforded to Chapter 11 debtors while avoiding the many accompanying obligations"); Francus, supra note 12, at 43 ("If the Texas Two-Step sounds like a fraudulent transfer, that's because it fits the textbook definition of one.").

[83] Some critics in the media and government have also implied that

bankruptcy proceedings rob plaintiffs of their right to a jury trial and their day in court provide tort claimants insufficient leverage and insufficient disclosure to negotiate for a good deal.

These critics have labeled the third-party release a get-out-jail-free card[85] and the two-step bankruptcy a brazen attempt to evade liability and escape the protections and costs normally associated with bankruptcy proceedings.[86]

Why, these critics ask, should any entity that has not filed for bankruptcy benefit from the bankruptcy process and be released from liability? And why should a firm be able to use bankruptcy to resolve its liabilities while designating certain assets to be unaffected by the bankruptcy proceedings? Based on these concerns, a growing number of scholars and policymakers have argued that the Bankruptcy Code does not authorize third-party releases and two-step bankruptcies, or that they are

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the releases in Purdue protected the Sacklers from criminal liability. But that is a frivolous argument Nothing in the bankruptcy code or any bankruptcy proceeding can stop a criminal proceeding of any kind, state or federal. Yet the idea has been floated by serious sources. See also https://www.cnn.com/2021/09/02/politics/what-matters-sackler-opioid-purdue-pharma/index.html ("Back alley drug dealers go to jail when they get caught. Corporate boardroom drug dealers can hide behind bankruptcy and keep most of their billions when they get in trouble."

Even the Attorney General of Connecticut made this odd statement:

> States retain our police powers, our law enforcement authority. That's what I do every day. I exercise the state of Connecticut's law enforcement authority. No federal judge can tell me that I can't assert my claims against criminals and wrongdoers.

Quoted here https://www.stamfordadvocate.com/business/article/This-is-an-outrage-CT-not-backing-down-16439823.php. Of course, no federal bankruptcy judge ever tried to tell him how to enforce criminal laws or police powers.

He later changed his tune when his state negotiated a large slice of the pie. At that point he admitted that Connecticut had slowed the recovery of other victims and decided to support the plan. He made this statement:

> No settlement will ever come close to addressing the magnitude of suffering and harm caused by Purdue and the Sackler family. But in reaching this $6 billion settlement we recognized that we could not stall this process forever for victims and our sister states. I thank the Bankruptcy Court for its approval.

With that noted, we do not address these arguments further.

[85] Durbin, *supra* note 12.

[86] *See* sources cited supra notes 8–10.

unconstitutional,[87] or that Congress should prohibit them through legislation.[88]

To foreshadow our arguments in Part III, we take a different view. As a starting point, it is worth noting that the concerns in the preceding paragraphs (like many rhetorical attacks on Chapter 11) omit two key points: Third-party releases and two-step bankruptcies are not free and they entail substantial judicial oversight. For third-party releases, most courts require that the released party provide some value.[90]

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[87] Although it is not our primary focus in this Essay, we note that we are not persuaded by the constitutional arguments against mass tort bankruptcies. These cases pose no Article III problem and do not violate the constitutional principles of federalism. These arguments were explored fully in Anthony J. Casey and Aziz Z. Huq, The Article III Problem in Bankruptcy. We briefly summarize the reasoning here.

The starting point is the constitutional authorization of Bankruptcy law authorizing Congress

> [t]o . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States" and also "[t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States

US Const Art I, § 8, cls 4, 18.

Regarding Article III, the power to create a uniform bankruptcy law includes the power to allocate to bankruptcy tribunals the authority to adjudicate matters that serve the core purpose of bankruptcy. "The adjudicatory power of a non–Article III tribunal can be defined in terms of the necessary scope of the bankruptcy. Such power extends to categories of claims that must be aggregated in a single forum if destructive collective action dynamics (and concomitant waste of state-created rights) are to be avoided". Casey and Huq at 1204. This is consistent with the Supreme Court's holding in *Stern v. Marshall*, 131 S Ct 2594 (2011), which allows bankruptcy courts to decide "matters integral to the restructuring of the debtor-creditor relationship." 131 S. Ct. at 2617.

This view of Article III protects against encroachment and federalism harms by limiting the reach of federal bankruptcy proceedings. "In brief, we argue that if a species of legal issue to be decided does not alter the creditors' collective relationship, then its adjudication is not integral to the restructuring of the general debtor-creditor relationship." Casey and Huq at 1161.

Finally, this approach is both consistent with long standing bankruptcy practice and "fits tightly with the Constitution's text, the structural goals that the Court has identified, and the Court's repeatedly expressed desire for an effectual limiting principle." Id. at 1164.

[88] *See* sources cited supra note 8.

[90] In re Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002) (setting forth an oft-cited seven-factor test for releases that includes that "[t]he non-debtor has contributed substantial assets to the reorganization").

Moreover, courts perform a searching inquiry into the need for the releases and require supermajority approval by the affected parties.[91] For two-step bankruptcies, the debtor always enters bankruptcy with a funding agreement in hand that provides it full access to the assets that were available prior to firm's split. That funding agreement must leave the claimants no worse off than they were before the split.[92]

If third-party releases and two-step bankruptcies were purely a means for abuse, judicial oversight and compensation would not cleanse them. But they are not inherently abusive maneuvers. Moving mass torts to Chapter 11 offers significant advantages for resolving the claims fairly and efficiently, thus ultimately benefiting all parties. Maneuvers like the third-party-release and two-step bankruptcy facilitate that move, and should therefore be welcomed and regulated, not prohibited.

II. Mass Tort Claims and Bankruptcy Problems

Despite the criticisms described in the previous Part, bankruptcy is, in our view, an appropriate form for resolving mass tort claims. Bankruptcy was designed to solve the collective action problem precipitated by financial distress. Mass torts present one such collective action problem, since plaintiffs who bring successful suits earlier are likely to drain the firm's resources, while inconsistent judgments could result in inequitable payouts even among plaintiffs who ultimately do collect.

[91] Id.

[92] This is true as a matter of Texas law, which applies to the divisional merger, TEX. BUS. ORGS. CODE ANN. § 10.901 (noting that nothing the merger statutes do not "affect, nullify, or repeal the antitrust laws or abridge any right or rights of any creditor under existing laws"); state fraudulent transfer or voidable transaction law, *see e.g.* 735 ILL. COMP. STAT. 160 (adopted from UNIF FRAUDULENT TRANSFER ACT, (UNIF. L. COMM'N 1984) (amended in 2014 as the VOIDABLE TRANSACTION ACT)); and bankruptcy law, 11 U.S.C. § 548 (prohibiting fraudulent transfers); see also Order Denying in Part and Granting in Part the Motion of the Debtor to Dismiss the Adversary Complaint and CertainTeed LLC's Motion to Dismiss Complaint and Brief in Support, In re DBMP LLC, Case No. 20–03023, Doc. 49 (Mar. 7, 2022); Complaint for Substantive Consolidation of Debtors' Estates with Certain Nondebtor Affiliates or, Alternatively, to Reallocate Debtors' Asbestos Liabilities to Those Affiliates, In re Aldrich Pump, Case No. 20–30608, Doc. 850 (Oct. 18, 2021).

a. Creditors' Race to the Courthouse

Scholars continue to debate why the United States needs a federal bankruptcy system, whether parties should be able to contract out of bankruptcy, and, assuming bankruptcy is necessary at all, which parts should be mandatory and which should be discretionary. Despite academic disagreement about when and under what circumstances bankruptcy is justified, most academics generally agree that there is *some* role for corporate bankruptcy[93] in addressing the collective action problem that occurs when multiple creditors hold competing claims against a debtor.[94] The disagreement is about who faces a collective action problem and why.

Douglas Baird and Thomas Jackson explored this idea in depth, arguing that bankruptcy should focus on addressing creditors' race to the courthouse.[95] Baird and Jackson were concerned that, absent a mandatory process that funneled all creditor claims into a single tribunal, creditors of financially distressed firms would avail themselves of individual remedies that would destroy the firm's going concern value. Even when firms are worth more operating as going concerns than sold off piecemeal, this race to the courthouse gives creditors an incentive to foreclose on assets as quickly as possible. Creditors know that they might not be able to collect if they wait to exercise their foreclosure rights, since all other creditors, with same

[93] *See* Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1809 ("[Bankruptcy] systems need not contain mandatory redistributional rules."); Lucian Ayre Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 777 (1988) (arguing that stakeholders should "receive a set of rights with respect to the securities of the reorganized company")

[94] *See id*; Schwartz (1998) at 1808 (1998) (explaining that bankruptcy solves a coordination problem); Douglas G. Baird, Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren, 54 U. Chi. L. Rev. 815, 827 (1987) see also Casey and Huq supra note __ at 1162 ("At its heart, bankruptcy can be understood as a strictly procedural solution to that collective action dilemma"); Douglas G. Baird & Randal C. Picker, A Simple Noncooperative Model of Corporate Reorganizations, 20 J. Legal Stud. 311, 311 (1991) (noting the traditional view that creditors face a collective action problem);

[95] Baird, Loss Distribution, supra note __, at 827 ("Jackson and I have asked why a parallel debt collection system is desirable at all. The answer, we assert, is the collective action problem."); Thomas H. Jackson, A Retrospective Look at Bankruptcy's New Frontiers, 166 U. Pa. L. Rev. 1867, 1872 (2018) ("[The collective action problem] was, if you will, my 'eureka' moment. I could suddenly see a reason for a bankruptcy law apart from the fresh start for the individual.")

concern will rush to exercise their own foreclosure rights to recover while they can. The result is that, absent a mandatory bankruptcy system, firms face disorderly, piecemeal liquidation even when they are worth more as a going concern.

That harms all parties. Creditors as a group will receive more compensation if they can agree to leave valuable but financially distressed businesses intact. Because creditors are dispersed and many, coordination toward that agreement requires a mandatory process preventing them from exercising their individual foreclosure rights. Hence the U.S. Bankruptcy Code.[96]

Bankruptcy law's core provisions address this collective action problem. The automatic stay prevents creditors from pursuing their claims individually in another court.[97] By blocking collection efforts outside of bankruptcy, the automatic stay stops the race to the courthouse and reduces administrative costs by consolidating all claims to a single forum. The absolute priority rule determines the order in which creditors and shareholders are paid.[98] While deviations from the absolute priority rule are sometimes permitted for administrative agencies or when the parties agree,[99] the absolute priority rule creates a default hierarchy of claims when negotiations fail. The prohibition on fraudulent transfers prevents debtors from evading creditors by diverting funds to a third party on the eve of bankruptcy.[100] It further mitigates the collective action problem by preventing a race to the courthouse just before a debtor files.[101] Without a prohibition on fraudulent transfers,

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[96] See NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984) ("The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources."). See sources cited in footnote 90.

[97] 11 U.S.C. § 362 (2018).

[98] 11 U.S.C. § 1129(b)(2)(B)(ii) (2018); *see also* Douglas Baird & Donald Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1937–1938 (2006); Douglas G. Baird, *Priority Matters, Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. PA. L. REV. 785, 786 (2017); Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 763 (2011).

[99] *See* Lindsey Simon, *Chapter 11 Shapeshifters*, 68 ADMIN. L. REV. 233, 238 (2016).

[100] 11 U.S.C. § 548 (2018).

[101] As discussed in the next subpart, the prohibition on fraudulent transfers will be especially important if third-party releases and divisional mergers become commonplace, since abusive third-party releases and divisional mergers can be unwound if they do not provide sufficient value to pay tort claims.

debtors may try to pay preferred creditors before filing for bankruptcy, and creditors might exercise collection rights prior to bankruptcy. The Bankruptcy Code allows corporations to restructure their debts and thus ensures that all of a debtor's obligations are dealt with in bankruptcy.[102] By stripping holdouts of their right to proceeding outside of bankruptcy, the Code prevents them from threatening costly litigation extract concession from the other firm and its other creditors.

b. Tort Creates a Collective Action Problem

Mass tort claims present precisely the type of collective action problem bankruptcy was designed to address. While scholars today debate whether capital markets have advanced such that bankruptcy is no longer needed to resolve contractual creditors' race to the courthouse,[103] those arguments do not apply to mass torts, since tort claimants are unable to contract in advance to protect themselves.

It is difficult, and often impossible, for tort claimants to contract with other creditors to protect their interests. It is one thing for lenders to contract with other lenders and debtors to protect their financial interests. But tort claimants are often dispersed and lack any established relationship with the debtor or its other stakeholders. When harms are latent and don't manifest immediately, as is often the case for carcinogenic products, victims may not learn of their injury for years. Perhaps most importantly, unlike contractual creditors, tort claimants typically do not voluntarily become claimants. They do not lend money to the debtor. They do not assume the risk of harm. They

[102] Some obligations attach to the reorganized corporation and are exempted from the discharge provisions.

[103] See Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709, 1710-1712 (critiquing the creditors' bargain theory and arguing that modern bankruptcy exists to solve the problem of incomplete contracting); Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW L. REV. 705, 709 (2019) (critiquing the creditors' bargain and arguing that bankruptcy provides value when there is reason to toggle between property rules and liability rules when companies are in financial distress); Barry E. Adler, *The Creditors' Bargain Revisited*, 166 U. PA. L. REV. 1853, 1864–65 (2018); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 778 (2002); Barry E. Adler, *A Theory of Corporate Insolvency*, 72 N.Y.U. L. REV. 343, 351 (1997) (asserting that the collective action problem described by Baird and Jackson is "largely illusory").

cannot protect their financial interests through contract when they do not have a contract in the first place.

Without a mandatory rule that consolidates claims in a single tribunal, tort claimants would rationally enter a race to the courthouse. Consider again the litigation about J&J's baby powder, which has been linked to ovarian cancer and mesothelioma.[104] Before LTL filed for bankruptcy, it had already spent almost $1 billion litigating these suits and paid approximately $3.5 billion in settlements and verdicts.[105] One Missouri jury awarded around $4.69 billion to twenty-two women.[106]

These numbers alone illustrate the potential for collective action problems and the need for bankruptcy protections for mass tort suits. If tort claimants were allowed to proceed individually, they could potentially destroy all JJJC's value. Just a dozen more verdicts like the one in Missouri, and JJCI is insolvent.[107] That verdict may have been an outlier, but it is not so unlikely to find 12 outliers in a sample that might include 80,000- cases.

And even if the claimants find a way to go after J&J,[108] claims could still potentially reach the point of threatening it's solvency. J&J ranks thirty-seventh on the Fortune 500's list of the largest American companies.[109] It lists $182 billion in assets.[110] Ignoring litigation costs, that means that ninety-one verdicts resulting in per-plaintiff awards of the sort awarded to the

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[104] See U.S. Food and Drug Admin, Press Release, Baby Powder Manufacturer Voluntarily Recalls Products for Asbestos (Oct. 18, 2019), https://perma.cc/EZ35-YYKA.

[105] See Brian Mann, *Rich Companies Are Using a Quiet Tactic To Block Lawsuits: Bankruptcy*, NPR (Apr. 2, 2022), https://perma.cc/8BXP-3G7Y.

[106] See Tiffany Hsu, *Johnson & Johnson Told To Pay $4.7 Billion in Baby Powder Lawsuit*, NYTIMES (June 12, 2018), https://www.nytimes.com/2018/07/12/business/johnson-johnson-talcum-powder.html.

[107] But see *In re LTL* (3rd Cir. 2023) (concluding that none of this creates financial distress or makes insolvency a meaningful threat).

[108] This seems like a difficult legal argument for claimants. Under standard corporate law doctrine, plaintiffs can typically bring claims only against the party that harmed them. Since 1979, J&J's baby powder was produced by Johnson & Johnson Consumer Inc. (JJCI) not J&J.

[109] See Fortune 500, Johnson & Johnson FORTUNE https://perma.cc/9267-2SL5.

[110] See SEC Form 10-K, at 41 (Jan. 2, 2022). It has a market capitalization of around $430 billion. Asset valuation is likely the more relevant number. But it only changes the analysis slightly to use $430 billion.

twenty-two plaintiffs in 2020 would be worth more than all J&J's current listed assets.

This creates a collective action problem. Even very large companies may be unable to fully satisfy all their tort obligations. The reality of corporate financial distress means that plaintiffs who file early may receive billions while those who file later are left with nothing. In fact, this was precisely the reason Congress encouraged bankruptcy courts to create asbestos trusts in the 1990s.[111] After asbestos litigation began to take off in the 1970s and 1980s,[112] courts were flooded with tort litigation. People who developed mesothelioma early received large recoveries. Those recoveries drained asbestos company assets and left little, if anything, for claimants who developed mesothelioma later. In similar mass tort situations, it is therefore rational for tort claimants to bring suit as quickly as possible to make sure that they receive a judgment while the company is still able to pay. If the company cannot pay all its tort obligations, then claimants who filed early receive a windfall, leaving nothing to those who waited.

The race to the courthouse is especially problematic in the tort context since some tort harms may manifest more quickly than others. A related concern is that, outside of bankruptcy, luck plays a large role in determining who gets paid. It is inequitable to advantage one tort claimant over another simply because that tort claimant's injury became evident at an earlier point in time. Similarly, some tort claimants may receive unusually sympathetic juries who award large damages. These considerations further emphasize that mass tort claimants will often be (on average) better off in a single proceeding. Moreover, since sophisticated parties will likely file and litigate to settlement or judgment more quickly than less sophisticated parties, one would imagine that well-resourced plaintiffs are better positioned to receive a large payout.

It is also worth noting that tort claimants' race to the courthouse is harmful to virtually all other claimants and other stakeholders of the debtor. The most obvious parties who are harmed are tort claimants who are unable to recover. In addition to them, however, shareholders and creditors are harmed when the specter of litigation prevents the debtor from raising debt or

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[111] *See* Douglas G. Smith, *Resolution of Mass Tort Claims in the Bankruptcy System*, 41 U.C. DAVIS L. REV. 1613, 1634 (2008) (providing a history of asbestos bankruptcies).

[112] Kane v. Johns-Manville Corp., 843 F.2d 636, 639 (2d Cir. 1988); Francis E. McGovern, *The Evolution of Asbestos Bankruptcy Trust Distribution Plans*, 62 N.Y.U. ANN. SURVEY AM. L. 163, 163-64 (2006).

equity in capital markets. That can waste resources as the company's costs increase due to uncertainty about future litigation. That, in turn, further harms the very tort claimants who are seeking to recover from the company, since the company's value declines as a result of uncertainty about future litigation costs. A mandatory proceeding in a single tribunal can thus reduce inequities among tort claimants by ensuring that similarly situated claimants receive the similar compensation, and it can reduce economic inefficiencies that arise when a company has no way of escaping its debts.

Bankruptcy also reduces the administrative costs associated with resolving mass tort claims. This is a solution to another collective action problem. Bring all claims into a single tribunal will typically be less expensive for all claimants to proceed, as doing so reduces duplicative litigation costs and shrinks the total share allocated to lawyers and other professionals. Even for solvent companies, spending resources on redundant litigation diverts value from public shareholders, employees, communities, and other beneficiaries.[113]

Without a mechanism like bankruptcy to force claimants into a single tribunal, separate courts will engage in redundant discovery, different plaintiffs will hire multiple attorneys to handle similar claims in various geographic regions, and courts and attorneys will have to educate themselves about different tort regimes.

Moreover, when nonbankruptcy tribunals cannot compel claimants to resolve their claims in that tribunal, claimants have an incentive to opt out of the primary jurisdiction in order to extract additional concessions. This will occur even if all (or the majority of) tort claimants would be better off if they collectively agreed to participate in a single proceeding.

It is presumably less expensive to sue J&J once instead of in every state where consumers purchased J&J baby powder. But if even a few plaintiffs prefer to bring their claims unilaterally and outside of the MDL or class action process, then they are in a position to jeopardize a recovery for everyone. A company is less likely to agree to a settlement when holdouts can still sue for billions, and it may feel compelled to retain some of its assets so that it can litigate against the holdouts.[114] Tort claimants, in turn,

[113] For example, in the case of J&J, the bankruptcy solution shifts resources from socially wasteful litigation to socially valuable operations like vaccine development. See infra note 131 and accompanying text.

[114] See Lahav supra __ at 16 ("Global peace is a great benefit to the defendant, who can move on without concern of mounting and never-

may be less inclined to settle when the company holds money back to litigate with holdouts.

Bankruptcy resolves these holdup and collective action problems. The automatic stay prevents tort claimants from pursuing claims outside of bankruptcy. It therefore ensures that cases are heard in one tribunal, by a single judge, and under a single legal process. By barring recovery for claimants who miss the claims filing date, bankruptcy prevents claimants from holding up a global settlement in the hopes that they will receive a larger payout in a separate proceeding. Further the prohibition on fraudulent conveyances and preferences bars debtors from providing excessive payments to their preferred stakeholders.

III. Third-Party Releases and Two-Step Bankruptcies: Potential Abuses and Benefits

Third-party releases and divisional mergers are also helpful in managing mass torts' collective action problem. Third-party releases are beneficial because they can bring money into the estate and thus increase recoveries for tort claimants. Two-step bankruptcies improve judicial efficiency by ensuring that only tort victims with an interest in the mass tort disputes are party to the bankruptcy proceedings. This prevents other creditors without a stake in the resolution process from trying to extract value by delaying the bankruptcy.

a. Third-Party Releases

The concern with third-party releases is that nondebtors use them to resolve liability for personal misconduct. But that is obvious: the effect of third-party releases is by definition to release nondebtors from liability. The important question is whether those releases are also improving outcomes for other stakeholders—especially tort claimants—and thus facilitating the fair and efficient resolution of tort claims rather than merely transferring value to the released party.

In our view, this depends on the circumstances of the release. When released third parties do not make sufficiently meaningful financial contributions, then they are illicitly taking advantage of the bankruptcy process to extract value and avoid their tort obligations. However, when third-party releases induce individuals and corporations to make significant financial contributions, they benefit tort claimants by enlarging the pie of recoverable funds and reducing the duplicative

ending litigation.").

administrative and legal expenses that arise when tort claimants sue the debtor in bankruptcy and the nondebtors in state and federal courts. We favor nonconsensual third-party releases because (a) they can reduce costs for all parties, and (b) it is possible to prevent their abuse through reforms while preserving their benefits.

Third-party releases facilitate global settlement and therefore address collective action problems that accompany financial distress. Tort claimants often have claims against multiple parties. This was evident in the Purdue bankruptcy, where tort claimants and state regulators sued both Purdue and the Sacklers for their role in the opioid crisis. Because Purdue was in bankruptcy, only the bankruptcy court could resolve claims against Purdue. The issue was whether the bankruptcy court should also resolve claims against the Sackler family.

Those with potential claims against the Sacklers overwhelmingly supported the bankruptcy court's decision to stay litigation against the Sackler family and then release them from liability for their role in the opioid crisis. Private plaintiffs, which included hospitals, insurers, and tort claimants, all supported a bankruptcy plan that released the Sacklers of liability.[115] At plan confirmation, ninety-six percent of opioid claimants supported the plan.[116]

Why would the third-party releases receive such overwhelming support from those who suffered the most from the opioid crisis? Because, by resolving claims against the Sackler family, the bankruptcy court ensured that a single tribunal heard all claims. When Purdue filed for bankruptcy, it faced over 3,000 active lawsuits filed in nearly every state in the United States.[117] Purdue's bankruptcy stayed litigation not only against the company, but also against the Sackler family, who had not filed for bankruptcy. The court's decision to stay litigation against the Sackler family was controversial since it barred individual plaintiffs from bringing suit in state court. But it was also necessary to improve judicial efficiency.

The Sackler third-party release is a solution to two related collective action problems. First, resoling claims against both Purdue and the Sacklers at the same time and in the same tribunal place conserves judicial. Fewer proceedings in fewer

[115] Mediators' Report, In re Purdue Pharma L.P., No. 19-23649, Doc. 1716 at 3-5 (Bankr. S.D.N.Y. Sept. 23, 2020).

[116] *See id*.

[117] *See* Brendan Pierson, Mike Spector, & Maria Chutchian, *U.S. judge tosses $4.5 bln deal shielding Sacklers from opioid lawsuits*, REUTERS (Dec. 16, 2021), https://perma.cc/PR9H-DB2W.

jurisdictions means lower legal fees and administrative costs. A single judge can efficiently manage all claims under the one set of procedural rules and the one discovery process, preserving value for the victims of the opioid crisis.

Second, and most crucially, non-consensual third-party releases prevent holdout creditors from undermining collective global settlements. If bankruptcy resolutions mandated full consensus, some tort claimants might seek additional concessions from the alleged tortfeasor by opting out of settlement.

By allowing the possibility of extending the injunctions and stays and then releasing the Sacklers, the bankruptcy system induces them to provide substantial funds to tort claimants without requiring victims to pursue further litigation.

But that inducement is worth much less if a small number of holdouts are able to opt out. In that world, the Sacklers would have had little, if any, incentive to settle because they would have been unable to resolve their tort liability in one proceeding.

Thus, a few holdouts could still unravel the entire agreement. The specter protracted litigation would likely have deterred the Sacklers from negotiating with other tort claimants. Why would they offer to settle if they still face hundreds or thousands of state court claims? Alternatively, the Sacklers may have offered less money to claimants who agreed to the release. That lower settlement amount, in turn, would have decreased the relative attractiveness of a bankruptcy settlement compared to the alternative litigation system.

The reason that the Sacklers needed to be induced to come to the bankruptcy bargaining table is that it had turned out to be very difficult to sue them. Virtually all direct lawsuits against the Sacklers had proven unsuccessful when Purdue filed for bankruptcy. Tort claims against the Sacklers faced many legal obstacles and claimants were unlikely to have been able to recover from the Sacklers outside of bankruptcy.

One might counter that reformers should focus on making it easier to sue people like the Sacklers. We don't disagree. To that end, one might argue that it should be easier to pierce the corporate veil,[119] or that shareholders should face unlimited liability for tort.[120] But that is easier said than done. One factor that critics have overlooked in the debate about the Purdue bankruptcy is that tort even legal successful tort

[119] *See* Jonathan R. Macey & Joshua Mitts, *Finding Order in the Morass*, 100 CORNELL L. REV. 99, 101-03 (2014).

[120] *See, e.g.* Rainier Kraakman & Henry Hansmann, *Toward Unlimited Liability for Corporate Torts*, 100 YALE L.J. 1879, 1890 (1991).

claimants were unlikely to recover fully from the Sackler family outside of bankruptcy. Indeed, most of the Sacklers had transferred their assets to trusts run by offshore accounts in places like Jersey in the Channel Islands (this Jersey is an island between England and France—not a U.S. state).[121] Any recovery would thus have been costly and time-consuming to achieve.

In the end, tort claimants only had leverage because the bankruptcy court had the authority (only with the consent of a supermajority of claimants) to release the Sacklers from liability. That leverage was used to bargain for a $6 billion contribution. The reason the Sacklers agreed to provide such an enormous amount of money to resolve their tort obligations is that they received something in return: the resolution of all Purdue-related tort obligations. From the plaintiffs' perspective, suing the Sacklers would have been a costly endeavor with a small chance of success. From the Sacklers' perspective, defending those suits would have been a costly endeavor with a very small chance of a large liability.

The global settlement converted the Sacklers' desire for certainty into a payout for victims. Without a global resolution, the Sacklers would have faced years of litigation across fifty states. While that litigation was unlikely to result in a meaningful payout for victims, there is always the chance that a specific jury will award significant damages to one claimant, and, in any event, years of litigation can prove costly and embarrassing. Thus, the *threat* of drawn-out litigation still gave claimants a powerful bargaining chip, which they leveraged into a $6 billion payout.. This outcome is laudable, not because of what it provided the Sacklers, but because it got more money quickly into the hands of victims.

Finally, even if non-bankruptcy reforms made it easier to sue the Sacklers outside of bankruptcy, third-party releases would still be a useful tool for resolving tort liability. Reforming nonbankruptcy law to facilitate findings of individual liability for corporate misconduct would increase recoveries for tort claimants both inside and outside of bankruptcy. Under that regime, one could expect that the $6 billion number would have been even higher. When someone faces the prospect of actually being held liable in a number of different courts, they will have even more reason to pay to globally resolution.

Outside of bankruptcy, tort claimants would still face the significant administrative costs of MDL, which has limited

[121] *How Purdue Pharma's Sackler Family Hid Their Cash*, CBS NEWS (Aug. 30, 2019), https://perma.cc/Q3QT-4SRU.

coordination mechanisms and no tools for binding future claimants. Neither can MDL solve the collective action problem, because dissenting claimants can opt out of settlements even when super majorities favor them.

Reaching global resolution is only possible when courts can compel participation. The ability of any tort claimant to opt out of a settlement eliminates third parties' incentive to contribute funds to resolve their own liability. In the case of the Sackler family, the settlement was only possible because the court compelled participation from claimants who wanted to opt out. Such claimants had legitimate reasons for their preference. They might have wanted to take a gamble on a large recovery even if the chances of recovery were slight. Or they may have thought they could convince the Sacklers to provide additional funds to secure their participation. Or they may have simply wanted to see the Sackler family suffer.

Regardless of the reason, however, that opt out would threaten the recovery of the class of claimants. That presents the classic collective action that bankruptcy is intended to solve. And third-party releases provide the solution.

One more issue lurks in the background of the third-party release cases. Scholars have argued that bankruptcy courts do not offer the same dignitary benefits as state and Article III courts.[125] The logic is that the Sacklers caused enormous harm and should be held to account in court, and their victims should get their day in court. We are sympathetic to this argument, but we do not think that it justifies destroying a global settlement that can provide a greater recovery than any other option. The realities of MDL mean that most tort claimants will not see their day in court anyway. Moreover, at the end of the day, the greater recoveries available from a global settlement outweigh other concerns. The Sackler family's contributions will fund rehabilitation and other health programs. It is troubling to allow three or four percent of claimants to derail a settlement approved by the vast majority of. Recall again that settlements require approval from a supermajority vote among the claimants. Ultimately our view is a subjective value judgment, and we acknowledge our utilitarian disposition in thinking that courts should try to maximize and expand recoveries for as many individuals who were harmed from corporate misconduct

[125] See, e.g., Oversight of the Bankruptcy Code, Part I: Confronting Abuses of the Chapter 11 System: H. Before the H. Comm. On the Judiciary Subcomm. On Antitrust, Commercial, and Administrative Law (Levitin testimony), https://perma.cc/9DMD-HJTS.

as possible, even if that means forcing a small number of claimants to accept the deal.

This discussion highlights the importance of the relationship between bankruptcy and non-bankruptcy remedies. The Sacklers wanted to settle with tort claimants because that would resolve all civil litigation related to their involvement in the Opioid crisis in a single proceeding. This was apparent when the Sacklers offered an additional $2 billion after state attorneys general objected to the initial offer and threatened to continue pursuing claims in state court. If the expected liabilities of litigation outside of bankruptcy are low, then the amount offered to resolve things in bankruptcy will also be lower. Thus, one way to increase bankruptcy payout, then, is to reform nonbankruptcy substantive law to increase liability.

That is because the cost of nonbankruptcy litigation also affects the offer of settlement in bankruptcy. Because settlement in bankruptcy allows the firm to avoid tort litigation, the higher the costs of litigation outside of bankruptcy, the more that parties involved with corporate misconduct are likely to offer to settle claims inside of bankruptcy. After all, the debtor wants to avoid those outside costs. In cases like LTL, failure of a settlement could mean that the case returns to the non-bankruptcy system.

The practical effect is that both bankruptcy and non-bankruptcy remedies combine to create a complicated bargaining scenario where the parties are negotiating over how to split the surplus created by avoiding the costs of litigation. The outcome will turn on who has the best information and who has the strongest bargaining position. To the extent that management possesses asymmetric bargaining power or information asymmetries, one might worry that bankruptcy proceedings will lead to lower payouts to tort claimants. While that might imply that reformers should make it more difficult for firms to file for bankruptcy protection to resolve tort claims, in our view, the reforms within the bankruptcy system that we propose in Part IV, some of which might make bankruptcy a less appealing venue for resolving civil liability, better address these concerns.[126]

But as we discuss below there are ways to correct for asymmetric information or uneven bargaining dynamics.

[126] We are particularly grateful to Jared Ellias, Michael Francus, and Arianna Vaisey for conversations that helped us clarify these thoughts.

b. Divisional Mergers

Divisional mergers further mitigate tort law's collective action problem by making it difficult for holdouts to derail settlements that improve recoveries for all parties, including tort claimants. The key insight here is that divisional mergers simplify the bankruptcy process and thereby prevent creditors from taking advantage of Chapter 11 proceedings to extract concessions.

Recall that divisional mergers separate a company's assets from its liabilities. One can think of these as being like a pre-package bankruptcy for tort claims. Bankruptcy is a costly process, one which gives creditors significant opportunity to interfere with corporate operations. Creditors can demand information about the company's operations, petition bankruptcy judges for protective orders, and even challenge management's business decisions. All these devices can facilitate the fair distribution of value when a firm is in distress. But these protections impose costs and slow things down. Their imposition is viewed necessary as balancing between the costs and benefits of preventing collective action problems from destroying value. It is possible to prevent the destruction at lower cost, that is always preferable.

With a divisional merger that cost reduction is possible. By segregate the firm's operations from its onerous liabilities without further harming parties with a claim on the firm's assets, the benefits of the bankruptcy (resolving the collective action among the claimants) is achieved without imposing the operational costs.

Divisional mergers thus offer two benefits for tort claimants. First, they simplify the bankruptcy process and thus increase judicial efficiency and reduce administrative expenses. It would be enormously costly for a debtor that faced significant tort claims to put its entire company in bankruptcy. Consider again J&J. J&J is a large company that manufacturers many different products. In addition to consumer goods, it produces pharmaceuticals and medical goods. It manufactured a vaccine that offers protection against Covid-19.

It would be complicated, to say the least, for J&J to reorganize at the parent level. The company has billions of dollars of corporate debt and hundreds of subsidiaries with a complex web of overlapping creditors.[131] In a bankruptcy, every

[131] *See* Johnson & Johnson Long-Term Debt 2010-2022, MACROTREND, (last updated Oct 1, 2022) https://perma.cc/UAT6-

single one of these creditors would have to file a claim and might be entitled to vote on the plan of reorganization. The bankruptcy judge would have to value these claims, and potentially any of those creditors would be able to object to decisions made durig the reorganization. An excessively complex, and thus costly, bankruptcy would leave less money for everyone, including the tort claimants against JJCI.

This disruptive process would harm the company and its creditors—including JJCI's tort claimants. If the company can simplify the bankruptcy proceeding without harming tort claimants, everyone is better off. In addition, the added complexity would increase the cost of the bankruptcy. An excessively costly bankruptcy would leave less money to pay everyone, including the tort claimants against JJCI. By allowing firms to separate their tort liabilities from their productive assets, divisional mergers reduce the costs and complexity of resolving tort claims. This would be problematic if firms underfunded the entities that took on the tort obligations, but again, that is a question of valuation.

The administrative complexity of reorganizing large companies such as J&J leads to the second justification for divisional mergers, which is that they prevent creditors from exercising their rights to hold up the bankruptcy in an attempt to extract value. Bankruptcy is designed to encourage creditors to reach an agreement to facilitate reorganization. Recognizing that creditors of distressed firms will likely take a loss, bankruptcy gives them significant procedural rights. They can challenge a discharge. They have a right to be heard before liquidation. They can often demand a creditor vote. The already-significant costs of these procedures grow with the size and intricacy of a firm's corporate.[132]

Bankruptcy's procedural rights are designed to protect creditors from opportunistic maneuvers by debtors and other creditors (especially those with more sophistication). They thus provide a benefit when a creditor risks taking a loss, but are counterproductive when they protect creditors who face no such risk. Because mass tort bankruptcies are designed to resolve *only* tort liability (not other financial claims), there is no reason to open the process to the participation of other financial creditors.

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[132] Kenneth Ayotte & Edward R. Morrison, *Valuation Disputes in Corporate Bankruptcy*, 166 U. PA. L. REV. 1819, 1824 (2018); Anthony J. Casey & Julia Simon-Kerr, *A Simple Theory of Complex Valuation*, 113 MICH. L. REV. 1175, 1188-89 (2015).

In fact, doing so would allow those other financial creditors to extract financial concessions from the debtor and other creditors by using their procedural rights to hold up corporate reorganizations. As Jared Ellias has shown, financial creditors will play hardball to secure a windfall during bankruptcy.[133] They do so by blocking or delaying a reorganization, or by negotiating a prepackaged plan that puts them in control of the bankruptcy proceeding.[134] Many of these strategies involve contracts between debtors and creditors.

The advantage of divisional mergers lies in their ability to simplify corporate reorganizations that involve mass tort claims.[135] Rather than drag all a company's assets and creditors into the bankruptcy, divisional mergers allow firms to separate their tort liabilities from the rest of their assets. Doing so blocks non-tort creditors from extracting value inserting themselves in the bankruptcy proceedings. The divisional merger is thus in the interest of tort claimants because it increases their relative leverage they and protects them from the risk that other creditors will extract concessions.

Note, moreover, that critics real objection to divisional mergers is often the third-party release that debtors are expected to request later in the case. The divisional merger has no effect itself on tort liability or recoveries because of the funding agreement that accompanies the division. But the divisional merger will be followed in bankruptcy by a request that the bankruptcy judge release the debtors' affiliate entities the tort liability.

As noted above, bankruptcy courts should require that debtors provide adequate capital in exchange for these releases that shields the rest of their assets from liability.

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[133] *See* Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 748-51 (2020); *see also* Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 867 (2014).

[134] *See id.*; *see also* David A. Skeel, Jr., *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366, 378-86 (2020) (describing contractual developments that distort bankruptcy procedures and allow sophisticated creditors to control the bankruptcy process). *But see* Edward J. Janger & Adam Levitin, *The Proceduralist Inversion—A Response to Skeel*, 130 YALE L.J. 335, 338-39 (arguing that Skeel downplays the coercive nature of restructuring support agreements).

[135] For a similar point, see Lahav supra note __ at 8 ("[T]he idea of packaging claims into a single entity of some kind where a pot of money awaits claimants is a feature of bankruptcy, the quasi class action in MDL, and the class action itself.")

Of course, if divisional mergers create underfunded subsidiaries that cannot pay tort claimants what they are entitled to before the divisional merger, that is a classic example of a fraudulent transfer and can and should be addressed with fraudulent transfer law rather than a blanket prohibition on divisional mergers.[136] Fraudulent transfer doctrine prohibits debtors from making transfers that hinder, delay, or defraud their creditors.[138]

If fraudulent transfer law fails to adequately deter companies from evading tort law by placing their tort obligations in underfunded subsidiaries, then policymakers should reduce the evidentiary burden needed to sustain fraudulent transfer claims, and increase the damages firms pay for fraudulent transfers.[139] A related concern is that, because incumbent managers have the best information about the value of a company's assets, they can use divisional mergers to divert value from tort claimants to other stakeholders. We discuss this concern in the next Part, when we explore reforms that could give tort claimants greater control over the bankruptcy process.

Because divisional mergers often simplify the resolution of mass tort claims and prevent financial and other sophisticated creditors from rent-seeking, judges and policymakers should address exploitative divisional mergers with measures aimed at (a) ensuring that the tort claims are valued correctly, (b) confirming that adequate funding is provided to the entity that assumes the tort liability, and (c) reforming and enforcing fraudulent transfer law. A blanket prohibition on divisional mergers would simply increase the complexity of resolving tort claims without addressing the valuation issues that actually create potential for abuse.

IV. Bankruptcy Reforms

The analysis above does not imply that the bankruptcy process is free from abuse, or that debtors and their affiliates do

[136] 11 U.S.C. § 548; Uniform Voidable Transfers Act; Uniform Fraudulent Conveyance Act; Uniform Fraudulent Transfers Act.

[138] It is also worth pointing out that divisional mergers are not the tool used for these types of fraudulent transfers. Spinoffs have always been possible, have always been allowed, and have long been used to construct fraudulent transfers. See Joshua Macey & Jackson Salovaara, Bankruptcy as Bailout, Stanford Law Review (2019). The response to fraudulent spinoffs has not been to prohibit them, but rather to use fraudulent transfer law to go after the bad ones.

[139] *See* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 836.

not take advantage of third-party releases and divisional mergers. To the contrary, there is evidence that bankruptcy is associated with lower recoveries for tort claimants, and that corporations have engaged in strategic reorganizations to minimize their financial responsibility for tort and environmental harms.[140]

But the solution to these problems should not be worse than the disease. As discussed above, the bankruptcy system's tools for managing collective action problems prove useful for resolving mass tort claims. Rather than restrict debtors' access the bankruptcy courts, policymakers should reform the bankruptcy system to make it more difficult for debtors and their affiliates to evade liability in the bankruptcy process. That can be accomplished through substantive and procedural reforms. We explore some of those potential reforms below.[141]

a. Substantive Reforms

Settlements in and out of bankruptcy occur in the shadow of bankruptcy's priority rules. Within bankruptcy, secured creditors usually recover first, then unsecured creditors with a priority claim, and lastly the remaining unsecured creditors.[142] With some exceptions, claims for environmental and tort obligations typically fall in the last bucket, as unsecured claims.[143] An effort to make nonadjusting creditors better off could start by giving tort claimants priority over other claimants.

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[140] *See* Judson Boomhower, *Drilling Like There's No Tomorrow: Bankruptcy, Insurance, and Environmental Risk*, 109 AM. ECON. REV. 391, 393 (2019); *See* Joshua C. Macey, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 921 (2019).

[141] We explore proposals that are consistent with those offered by bankruptcy scholars in the past. In particular, scholars have long urged policymakers to reform bankruptcy's venue rules, give tort claimants a priority claim, and increase tort claimants' ability to appeal bankruptcy decisions. *See* Kathryn R. Heidt, *Cleaning Up Your Act: Efficiency Consideration in the Battle for the Debtor's Assets in Toxic Waste Bankruptcies*, 40 RUTGERS L. REV. 819, 851-63 (1988); Barry E. Adler, *Financial and Political Theory of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 340 (1993) ("Ideally, nonconsensual claimants would have highest priority [in bankruptcy]").

[142] 11 U.S.C. § 36 (2018).

[143] *See* Vincent S.J. Buccola & Joshua C. Macey, *Claim Duraiblity and Bankruptcy's Tort Problem*, 38 YALE J. REG. 766, 774–81 (2021) (explaining how bankruptcy treats nonadjusting creditors); Mark J. Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846, 847 (1984).

Moreover, if corporations use divisional mergers and third-party releases to underpay nonadjusting creditors, then policymakers should reform fraudulent transfer law to allow tort and environmental claimants to pursue debtors and third parties who conveyed assets to shield them from these nonadjusting creditors.

These are the classic bankruptcy reforms that scholars have proposed to stop firms from externalizing social costs through bankruptcy.[145] We have little to add to these debates besides observing that many of the difficulties tort claimants face in collecting from a distressed firm are old problems with old solutions. The fact that bankruptcy offers advantages for resolving mass tort claims compared to the civil litigation system does not mean that it operates optimally today. The substantive reforms that legal scholars have proposed over the past four decades to address environmental and tort obligations would go a long way toward also improving outcomes for tort claimants in cases where third-party releases or divisional mergers are used to maximize recoveries.

b. Procedural Reforms

In addition to these substantive reforms, policymakers should consider procedural changes to prevent debtors from using bankruptcy to escape their tort obligations. Here, too, we agree with suggestions by many bankruptcy scholars, especially Lindsey Simon and Samir Parikh, that courts should require debtors and their affiliates to provide adequate disclosure and carefully value their tort obligations.[146] We note however that, in many circumstances, this describes the current process for most mass tort bankruptcies.[147]

i. Valuation

[145] *See* 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); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1569 (1991) (arguing that tort claimants should receive priority in bankruptcy); Heidt, *supra* note 141, at 841 (arguing that environmental claims should receive priority in bankruptcy).

[146] *See, e.g.* Samir D. Parikh, *Modern Forum Shopping in Bankruptcy*, 46 CONN. L. REV. 159; Simon, *supra* note 35, at 1207–1210.

[147] See Purdue proceedings (requiring extensive discovery and disclosures).

For bankruptcy to provide a viable alternative to MDL and class actions, judges should impose safeguards to ensure that tort claimants are better off resolving their claims in bankruptcy than in another forum. This requires a baseline rule against any bankruptcy plan that leaves tort claimants worse off than they would have been outside of bankruptcy. The Bankruptcy Code already requires this. But implementing the requirement is difficult and the mechanics of valuing tort claims are necessarily imprecise. Judges cannot know with certainty whether tort claimants would have been worse off outside of bankruptcy unless they allow the claims to proceed outside of bankruptcy. That, of course, would defeat the purpose of bankruptcy as a mandatory venue in which to negotiate a global settlement.

Still, bankruptcy judges should (and often do) make a good faith effort to determine whether a bankruptcy settlement leaves tort claimants worse off than they would have been outside of bankruptcy. Tort claims often reach bankruptcy after the debtor has already litigated some cases outside of bankruptcy.[148] Those cases can help experts estimate the debtor's expected liability under the ordinary tort system. Moreover, in many cases, companies will commit to making available all of their value as a going concern to satisfy liability to tort claimants. That was Purdue's strategy when it filed for bankruptcy.[149] It is also arguably what J&J did when it committed to provide the full value of Old or New JJCI to satisfy all eventual liability. In these cases, tort claimants cannot collect more in another forum, since the company is already setting aside all of its available assets to pay them.

But that conclusion assumes that the valuation of assets and liabilities remains constant across forums. J&J's bankruptcy highlights this key idea and the difficulties of accurate valuation right. There are three challenges when valuing tort obligations in bankruptcy. J&J's divisional merger illustrates each in turn. The first is the fact that J&J's guarantee of $61 billion to cover liabilities is based on the estimated value of Old JJCI's assets at a certain point in time.[150] The valuation for purposes of the final

[148] *See* Johnson & Johnson, Press Release, *Statement on Talc Resolution*, JOHNSON & JOHNSON (Oct. 13, 2020), https://perma.cc/YY55-DTLW (announcing a talc settlement).

[149] *See* Jan Hoffman & Mary Williams Walsh, *Purdue Pharma, Maker of OxyContin, Files for Bankruptcy*, NYTIMES (Sept. 15, 2019), https://www.nytimes.com/2019/09/15/health/purdue-pharma-bankruptcy-opioids-settlement.html.

[150] Declaration of John K. Kim First Day Declaration, *supra* note 74,

payment will be made when that payment becomes due. But that estimate could be flawed; it if it undervalues the company, the tort claimants may recover less than they are due or would have by simply becoming equity holders of Old JJCI. On the other hand, if the valuation is too high, then the tort claimants might end up better off (assuming that liabilities are also high enough for them to have a claim on the surplus).

In JJCI's case, J&J has provided tort claimants additional protections to cover actually appreciation and proect against actual depreciation of assets by agreeing to pay "any and all costs and expenses' up to the value of New JJCI."[151] That means the worst-case scenario for JJCI's tort claimants is that they receive up to the estimated value of Old JJCI at the time of the divisional merger (even if that value has disappeared because JJCI's asset have decreased in value). This is exactly what they would have been entitled to outside of bankruptcy, and in the absence of the divisional merger.

The best-case scenario is that JJCI increases in value, in which case the tort claimants may be able to recover more (again this assumed their claims of liability total more than $61 billion). In other words, the divisional merger can only leave the tort claimants better off than they would have been outside of bankruptcy and without the divisional merger.[152] The funding agreement also protects against subsequent asset transfers, guaranteeing that the value of the transferred assets will remain available to the claimants.

Still, none of this protects against errors in the determination of those actual values. And the valuation difficulty increases if J&J has the best information about the value of its assets, including JJCI. In some situations, this asymmetric information means that a valuation based on a company's present value may not actually its actual value. The same is true of the valuation of any asset transfers.

Though fraudulent transfer law would ideally prevent New JJCI from engaging in this type of behavior. It may therefore be worth reducing the evidentiary burden for fraudulent transfer claims or increasing the associated penalties to better deter post-divisional merger conduct aimed at shielding funds from tort claimants. But even aggressive

¶ 9-10, 21.

[151] Memorandum Opinion, In re LTL Management LLC, Case No. 21-30589, Doc 1572, 5 (Feb. 25, 2022).

[152] Ironically, this extra protection that J&J made available to the claimants led the Third Circuit Court of Appeals to dismiss the case for lack of good faith.

enforcement of fraudulent transfer law does not mean that J&J and other debtors will not try to leverage information asymmetries to take advantage of tort claimants.

The second issue is that if the LTL case leads to third-party releases for New JJCI and J&J, tort claimants should receive compensation from the released third parties. Although JJCI was the legal entity that manufactured and sold Johnson & Johnson baby powder, plaintiffs have also sued J&J under various theories of vicariously liability.[154] While such claims had not been successful when LTL filed for bankruptcy, they might have proven more successful in the future. In any event, J&J would receive significant value if JJCI's divisional merger results in a global settlement that releases J&J from liability because it will no longer need to expend resources defending additional suits. It would be inequitable for J&J to receive all of that value, J&J and other entities that secure third-party releases in bankruptcy after effectuating divisional mergers should pay some of that value to the tort claimants who are foregoing their right to sue the released party.[155]

But valuing such releases is difficult. It is hard to estimate the surplus generated by avoiding the prospect of years of litigation. It is thus important for bankruptcy judges to take valuation seriously. It also means that tort claimants should have enough negotiating leverage to demand an adequate contribution for the release. If the purpose of bankruptcy is to facilitate a global settlement, then parties must have sufficient negotiating leverage to demand fair treatment. Bankruptcy judges should thus require supermajority approval from tort claimants to authorized a release, and ensure that those tort claimants are fully informed about the rights they are giving up. Many couts require this already.

The final valuation challenge arises because bankruptcies often resolve tort claims that have yet to manifest. When a corporation manufactures a product that causes mesothelioma, the firm may file for bankruptcy despite the fact that some consumers will not develop cancer and others, who will, may not fall ill until well after the bankruptcy has concluded. In such circumstances, it can be difficult to estimate how much money the corporation should contribute. It is possible that the court underestimates the degree of harm or the number of victims.

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[154] *See id*.

[155] See Douglas G. Baird, Anthony J. Casey, Randal C. Picker, The Bankruptcy Partition, 166 Penn L. Rev. 1675 (2018).

Information asymmetries exacerbate this issue as well. A corporation that knows it has manufactured a particularly risky product may downplay the risks or file for bankruptcy before the risks are fully apparent, and secure a release from liability.

That raises the question of how to deal with unknown future claimants. As a threshold matter, it is worth noting that this issue is a challenge both inside and outside of bankruptcy. When claimants injuries manifest years after exposure, they may not be able to identify or sue any defendant. Prior lawsuits may have driven the defendant out of business. Or if the company has reorganized, it may be difficult to bring a claim of successor liability. In these situations, as in bankruptcy, claimants whose injuries arise years after exposure may struggle to successfully bring a tort claim.

In our view, the bankruptcy process provides the least bad option for these claimants. Future claims representatives are often appointed to negotiate on behalf of such claimants.[156] These court-appointed agents negotiate on behalf of claimants whose injuries have not yet occurred. They should reserve a percentage of funds for these claimants, and, where the value of future claims is uncertain, they could include provisions allowing a petition to have the trust replenished by the parent company after the plan of reorganization. This may be imprecise, and it may require ongoing interactions between tort claimants and the parent company, but these are challenges bankruptcy courts have addressed for decades.

The valuation challenges we have just discussed are significant, and they may allow debtors to gain leverage in bankruptcy proceedings.[157] Perhaps because of this potential for asymmetric power, bankruptcy scholars frequently critique nonconsensual third-party releases for providing the benefits of bankruptcy without the associated costs.[158] They argue that the law should impose some burden on the debtors to account for the benefit they are gaining.

We are sympathetic to the argument that asymmetries should be corrected. But we do not think the best way to do that is to impose unnecessary costs just their own sake or to impose

[156] There are agency problems with future claims representatives that need to be addressed. See Fred Tung, https://www.chapman.edu/law/_files/publications/CLR-3-frederick-tung.pdf; see Lahav supra __ at 14-15.

[157] Here we endorse Lindsey Simon's proposals for improving bankruptcy disclosures. *See* Simon, supra note 35, at 1205-10 (advocating for improved disclosure and discovery in bankruptcy).

[158] *See* sources cited supra note 8.

some sort of punishment on the debtor. Bankruptcy law has never been means of punishment and certainly not when that punishment entails destroying value that would otherwise be available for stakeholders. Nothing that is more antithetical to the purpose of bankruptcy than destroying estate value to punish someone.

Rather the remedy for asymmetric power and limited information is to require debtors and non-debtors who resolve liability in bankruptcy to makes a full disclosure about their financial affairs and that tort claimants can to hire experts to assess the debtors' and non-debtors' assets and the size of the tort obligations. Without such disclosures debtors should not be able to reach a full and final resolution of their claims.

ii. More Radical Proposals to Address Information Asymmetries, Bargaining Dynamics, and Debtor-in-Possession Control

So far, we have discussed conventional tools for reform to reduce the potential for abuse in mass tort bankruptcy. Many of these tools are already in use by bankruptcy courts. Some may think these tools don't go far enough. And so it may worth considering more radical reforms that would prevent debtors from using information asymmetries to divert value from tort claimants to other stakeholders. We have doubts at this point as to whether such reforms are necessary or justified. But if abuses need to mitigated, we view these reforms as superior to any reforms that intentionally increase the cost of bankruptcy or cut off the option of bankruptcy proceedings as a means of resolving mass tort cases.

As a default, U.S. bankruptcy law allows debtors to operate the firm during bankruptcy. It also gives the debtor in possession the exclusive right to propose a plan of reorganization.[159] There are good reasons to do this. Incumbent managers have experience running the firm, and likely possess better information than anyone else about the firm's business opportunities, the causes of its distress, and the its day-to-day operational needs. A system that automatically ousted existing executives could therefore create significant operational difficulties.

But for the same reasons that existing managers are often best-equipped to manage a distressed firm, they are also best-

[159] During the first 120 days or eighteen months.

postitioned to use their information advantages to divert value away from tort claimants. We explore three potential reforms aimed at preventing this: eliminating the debtor in possession's exclusive right to propose a plan of reorganization, appointing independent board members whose job is to represent tort claimants, and replacing the existing board and management with a trustee or other custodian

One way to mitigate information asymmetries would be to allow tort claimants as a class to propose a plan of reorganization. The Bankruptcy Code gives the debtor the exclusive right to propose a plan of reorganization for 120 days after the bankruptcy petition,[160] which the debtor can extend to up to eighteen months.[161] By giving debtors the exclusive right to propose a plan of reorganization, the Bankruptcy Code reduces the administrative costs of resolving complex corporate reorganizations.

Giving debtors the exclusive right to propose a plan of reorganization may allow managers to reduce the value of tort claimants' recoveries. This could occur for two reasons. First, managers may asymmetric information and simply know more about the value of certain assets and claims. If they believe assets will turn out to be worth more, they may push to resolve claims based on a low valuation.

Alternatively, even with no information asymmetries between managers and tort claimants, managers may gain bargaining leverage via the exclusive plan-proposal power. It is a tenet of bargaining theory that a party who can make a take-it-or-leave it offer gains leverage and can ultimately capture a larger share of surplus value.

The exclusive ability to propose a plan, creates this take-or-leave-it dynamic. If a debtor proposes a settlement plan that the claimants reject, the claimants will have to wait even longer for a resolution. The bargaining dynamic can thus pressure them to vote in favor of a plan that overly disfavors them relative to other stakeholders and managers.

Both these issues could be partially resolved by amending the Bankruptcy Code to allow tort claimants to propose a competing plan of their own. For example, in Purdue, the tort claimants might propose a competing plan that is identical to the Debtors plan save for the no non-debtor releases and and accompanying $6 billion contribution from the Sacklers. Allowing the claimants to vote on both plans, would allow the

[160] 11 U.S.C. 1121(b).
[161] See id.

claimants to clearly express their preference between the $6 billion now and the right to sue the Sacklers later.

It might be that the claimants prefer either of these plan to nothing, so the judge should want to set up the voting rules to require a supermajority for any plan to pass, but also to provide information about the victim's ordered preference between the two proposed plans.

This reform could further legitimize mass tort bankruptcies because the tort claimants would themselves be responsible for proposing the plan that leads to their financial recoveries. Finally, eliminating the debtor's exclusive right to propose a plan could increase the tort claimants' share of the surplus generated by the reorganization because the counter proposals would be improved in order to secure more votes or even to induce the claimants representatives to forego proposing a plan. In our example, this could play out such that the Sacklers—fearing that the claimant's will propose a no-relase plan that prevails—might up their contribution to $8 or $10 billion.

The costs of this reform are added negotiation complexity and the administrative costs related to adding a non-management plan proposal. It is worth noting that these costs will be lower in divisional mergers where the debtor has no operations and only one group of creditors who might propose a competing plan. Indeed, the innovation of the divisional merger actually reduces the cost of removing the debtor's exclusive right to proposed a plan.

An additional, and potentially complementary, reform could be to allow tort claimants to elect representatives to the debtor's board of directors. Even without a majority of board members, their representatives would be able to advocate for their interests, and they would be involved in decision-making and demand information from management. Board representation could thus complement the plan-proposal right as additional information could improve tort claimants' ability to propose a realistic and favorable plan of reorganization.

The most radical reform would be to oust incumbent managers of firms that file to resolve significant tort liability.[162] This would be akin to appointing a trustee and would thus fully

[162] This occurred under the old Chapter X. See Chandler Act of 1938, Pub. L. No. 75-696, 52 Stat. 840, §§ 156, 158 (codified as amended in scattered sections of 11 U.S.C.). For a discussion of some of these issues, see Vincent S.J. Buccola, Sponsor Control: A New Paradigm for Corporate Reorganization, U. Chi. L. Rev. 1, 8-11.

mitigate managers abuse of asymmetric information and bargaining.

But firing incumbent managers also has significant costs. It removes the individuals with experience running the firm, and deters managers from filing in the first (if they have a desire to keep their job). While one could address the problem of managerial reluctance to file by making it easier for tort claimants to request an involuntary bankruptcy, we think that, as a general matter, it makes sense for existing management to run the firm during the bankruptcy; it would be highly disruptive to force a firm to onboard new management while trying to resolve potentially billions of dollars of liability.

But perhaps this reform could be effective in extreme cases. If there is evidence that managers are abusing the bankruptcy process, trying to hide assets, or acting without transparency and candor, then perhaps bankruptcy judges should replace existing managers with an independent trustee charged with representing the interests of tort claimants. Again, the costs of this reform might be lower for two-step bankruptcies. With a divisional merger the debtor has few, if any, operations to manage, and so the cost of removing management is accordingly much lower.

Another potential reform to balance bargaining leverage could be to hold debtors to a higher standard when they seek to stay lawsuits against non-debtors while the bankruptcy is pending. This is essentially what is playing out currently in the 3M/Aearo case where the bankruptcy court denied a motion to enjoin litigation against 3M during the bankruptcy. That case is currently on appeal at the United States Court of Appeals for the Seventh Circuit. Raising the standard for staying non-bankruptcy litigation would not prohibit third-party releases at the end of the plan, but it would allow the competing lawsuits to proceed until the plan is confirmed. This would give the debtor's managers and the non-debtor defendants an incentive to avoid delay in settlement negotiations or to reach an agreement where they might make early concessions in order to get the class of claimants to consent to a stay or injunction.

V. Conclusion

The interaction between bankruptcy and tort stirred up controversy as corporations have turned to the bankruptcy process to resolve allegations of sexual assault, opioid and products liability, and environmental cleanup obligations. The use of bankruptcy to resolve tort and environmental obligations has led to concerns that firms are manipulating the process to impede tort claimants' recovery, and that nonconsensual third-party releases and divisional mergers reflect deliberate attempts to evade tort liability.

As we have shown, the reality is more complicated. There are certainly examples of corporations abusing the bankruptcy process to evade their tort obligations, and third-party releases and divisional mergers can certainly facilitate these abuses when left unchecked.

But bankruptcy can also be enormously valuable for all stakeholders—including tort claimants. Bankruptcy is a solution to the collective action problem that arises when creditors of distressed firms race to the courthouse, desperate to collect what they can. Recent bankruptcy filings have illustrated that the tools that were designed to address the collective action problem among contractual creditors prove just as valuable in the tort context. Despite recent controversies, third-party releases and two step bankruptcies can reduce costs and facilitate bankruptcy proceedings that prevent a value-destroying race to the courthouse. Proposals circulating in the bankruptcy literature aimed at preventing debtors from using Chapter 11, would thus increase the costs of resolving mass torts to the detriment of the very tort claimants that such proposals are intended to protect. Policymakers should reject such proposals and embrace bankruptcy as a solution to mass tort's collective action problem. They should reform bankruptcy from within, not impose additional burdens on mass tort resolutions that will ultimately harm all stakeholders, including mass tort claimants.