TAking Future Claims Seriously:
Future Claims and Successor Liability in Bankruptcy

Frederick Tung

I. INTRODUCTION ............................................................................................. 3

II. SUCCESSOR LIABILITY .................................................................................. 12
   A. Form and Substance in the Sale of a Business ............................................. 13
       1. Merger v. Asset Sale .................................................................................. 13
       2. Loss Distribution ....................................................................................... 19
   B. The Successor Liability Doctrine ................................................................. 20
       1. The Business Continuation Exception ..................................................... 21
       2. The Product Line Exception .................................................................... 24
   C. Assessing Successor Liability ..................................................................... 26
       1. The Proper Rationale: Cost Internalization ............................................ 28
       2. Implications for Distress Situations ....................................................... 35
   D. Summary ....................................................................................................... 40

III. BANKRUPTCY REORGANIZATION AND BANKRUPTCY SALES ............... 41
   A. Reorganization and the Common Pool ......................................................... 41
   B. Future Claims and the Common Pool .......................................................... 44
   C. The Bankruptcy Sale .................................................................................... 45

IV. FUTURE CLAIMS IN REORGANIZATION .................................................... 47
   A. Including Future Claims .............................................................................. 50
   B. Mandatory Inclusion versus Flexibility ...................................................... 53
   C. Transaction Costs and Conceptual Clarity ................................................... 57
       1. The “Traditional” Approach in the Mass Tort Context ............................. 58
       2. Pragmatism with Future Claims ............................................................... 63
          a) “Creditors” and “Claims”: The Statutory Issue ....................................... 64
          b) Judicial Pragmatism .............................................................................. 67
   D. A Flexible Approach in External Reorganization ......................................... 71
       1. Internal v. External Reorganization ............................................................ 72
          a) A Note on Internal Reorganization ....................................................... 72
          b) Opportunism in External Reorganization ............................................. 73
       2. Current Creditors’ Calculus .................................................................... 74
          a) The Quick and Dirty Sale .................................................................... 76
          b) The Strategic Liquidation ..................................................................... 79
       3. Consequences for Future Claimants ....................................................... 81
       4. A Note on Transaction Costs .................................................................... 84
       5. Equal Treatment of Future Claims ............................................................ 87

V. SUCCESSOR LIABILITY AND EXTERNAL REORGANIZATION ................. 93
   A. Enjoining Successor Liability in External Reorganization ........................... 94
       1. Chapter 11 Discharge and the Channeling Injunction ............................... 98
       2. The Channeling Injunction and Bankruptcy Norms ................................ 99
   B. Judicial Hostility to the Bankruptcy Solution .............................................. 103
       1. Loss Spreading and the Common Pool ..................................................... 107
       2. Cost Internalization and Bankruptcy ....................................................... 110

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VI. IMPLEMENTATION .......................................................................................................................... 116
   A. PROSPECTS FOR THE TRADITIONAL MODEL ........................................................................... 116
   B. ONE ALTERNATIVE: COMMENSURATE DISCOUNTED ASSUMPTION ...................................... 120
      1. The Idea ..................................................................................................................................... 120
      2. Limitations and Implications ..................................................................................................... 124
         a) Due Process ............................................................................................................................. 124
         b) Successor Liability Issues ..................................................................................................... 126
         c) Transaction Costs in Claim Resolution .................................................................................. 128
   C. POLICING INCLUSION OF FUTURE CLAIMS .............................................................................. 129

VII. CONCLUSION: IMPERFECT SOLUTIONS ............................................................................... 132
TAKING FUTURE CLAIMS SERIOUSLY: FUTURE CLAIMS AND SUCCESSOR LIABILITY IN BANKRUPTCY

Frederick Tung*

Imagine that a small private airplane crashed into your living room. Your arm was broken, but thankfully, none of your loved ones were hurt. You did have something of a sentimental attachment to your living room, which is now in shambles. Times being what they are, you naturally look for someone to sue. Unfortunately, the pilot of the plane was not as lucky as you. Her demise eliminates one potential defendant. So you look to the manufacturer. It turns out the manufacturer went into bankruptcy last year, selling its business lock, stock and barrel to another company. Afterward, it dissolved.

Except for the fact that the manufacturer no longer exists, your lawyer informs you, you would have had a good cause of action against it. However, you might be able to recover from the company that acquired the business. Your prospects may depend on any or all of the following: (i) the terms of sale between the manufacturer and the acquirer, (ii) any order of the bankruptcy court approving the sale, (iii) whether provision was made in

* Associate Professor of Law, University of San Francisco School of Law. A.B. 1983, Cornell University; J.D. 1987, Harvard University. Many thanks to Lynn LoPucki, Michael Green, David Epstein and Kate Heidt for thoughtful conversation and invaluable critique of earlier drafts of this Article. Any errors or omissions were committed against their better advice and remain my responsibility alone. Research for this Article was supported by a grant from the University of San Francisco School of Law.
bankruptcy for compensation of future crash victims, (iv) whether the acquirer continues to make a version of the same plane, (v) which state’s law applies, and (vi) whether you read the notice in the newspapers last year announcing the manufacturer’s bankruptcy and sale of its business.

You scratch your head.

“You” have a problem. You have a claim against a business that is now defunct. Well, not exactly defunct. The business still exists. But it is now owned by an entity different from the one that manufactured the airplane that changed your life. At the time of the manufacturer’s bankruptcy and sale of its business, neither the manufacturer nor the acquirer knew of your existence.

While they probably anticipated that a certain number of planes would crash over time, there would have been no way to identify you as a future crash victim or to quantify your particular damages. One consequence of the sale is that you may be left with no means of recovery. You may be surprised to find that this is “no great wrong.”\(^1\) At the time of the sale, you were merely a future claimant.

\(^1\) Cf. In re Piper Aircraft Co., 162 B.R. 619, 625 n.9 (Bankr. S.D. Fla. 1994), modified by Epstein v. Official Committee of Unsecured Creditors (In re Piper Aircraft Corp.), 58 F.3d 1573 (11th Cir. 1995). In the process of disallowing a $100,000,000 claim filed on behalf of future claimants, the court opined that no provision need be made for them because there was “no ‘great wrong’” to be redressed. Whereas in certain mass tort cases, manufacturers had produced and distributed products known to be harmful, the court reasoned, only a very small percentage of the debtor’s extant fleet of aircraft would crash because of manufacturing or design defects. The now-famous Piper decision is more fully discussed infra Part IV.C.2.
I. INTRODUCTION

While the term “future claim” came into vogue with the mass tort cases, future claims plagued the legal system long before asbestos became a household word. Whenever a firm sells its business and subsequently dissolves, it leaves behind potential liabilities that might go unpaid. If the business is a manufacturing business, a product of its manufacture may cause injury long after the enterprise is sold and the original corporation has disappeared.

The sale and dissolution marks a day of reckoning among the acquirer of the business, the selling or target firm, and its creditors and shareholders. Assets and liabilities are valued and divvied up between acquirer and target, and consideration paid. The target firm will then dissolve, paying its creditors from the proceeds of the sale, distributing the surplus to shareholders, 


3 While the firm could take one of several different forms, this Article will assume the firm’s use of the corporate form. The transactions that implicate future claims and successor liability are almost always between corporations.

4 A similar problem involves future environmental liability under CERCLA, the Comprehensive Environmental Response Compensation and Liability Act, 42 U.S.C. §§ 9601-9675 (1994), and similar state statutes. See generally, Michael D. Green, Successors and CERCLA: The Imperfect Analogy to Products Liability and an Alternative Proposal, 87 NW. U. L. REV. 897 (1993) [hereinafter Green, Successors and CERCLA]; Kathryn R. Heidt, Environmental Obligations in Bankruptcy: A Fundamental Framework, 44 FLA. L. REV. 153 (1992). While future environmental liabilities lend themselves to analysis similar to future products liability, this Article will focus on the latter, and the term “future claim” will refer to future products liability claims only.

and then disappearing. Future claims, however, defy facile treatment on the day of reckoning. “Future claims” are those potential future products liabilities that exist on the day of reckoning. The manufacturer’s liability-creating conduct has already occurred, but any harmful consequence has yet to appear.\(^6\)

Ordinarily, when the business is sold, future claims are ignored.\(^7\) The future claimant and her future injuries are not vivid to the corporate tortfeasor, the acquirer, or any other relevant observer.\(^8\) At the time of sale and dissolution, it may be difficult to estimate the aggregate amount of future liability. It may not be possible even to identify, or describe except in general terms, the individuals who may later suffer injury.\(^9\) They may be ascertainable

\(^6\) For example, the defective manufacture of an aircraft and its release into commerce may ultimately result in liability for the manufacturer. Any harm, however, may arise only decades after the manufacture of the aircraft. See infra notes 12-13.

\(^7\) At the time of sale, future tort injuries may not even have been contemplated. However, in many if not most cases, the nature of the product-related injuries at issue were or could reasonably have been anticipated at the time of sale. See, e.g., Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714 (1st Cir. 1994) (involving defective firearm); Ray v. Alad, 560 P. 2d 3 (Cal. 1977) (involving defective ladder); Epstein v. Official Committee of Unsecured Creditors (In re Piper Aircraft Corp.), 58 F.3d 1573 (11th Cir. 1995) (involving future plane crashes).

\(^8\) See generally Richard Nisbett & Lee Ross, Human Inference: Strategies and Shortcomings of Social Judgment 43-62 (1980) (finding that cognitive processes tend to lead us to overemphasize information which is most concrete and “vivid”); Shelley E. Taylor & Suzanne C. Thompson, Stalking the Elusive “Vividness” Effect, 89 PSYCHOL. REV. 155 (1982) (questioning evidence supporting vividness effect, but proposing salience-vividness effect to explain differential impact of vivid information under conditions of information competition); Roe, supra note 2, at 855 (noting society’s willingness to spend more on current identifiable victims and less on future statistical victims despite expert consensus that dollars are better spent on latter); Thomas A. Smith, A Capital Markets Approach to Mass Tort Bankruptcy, 104 YALE L.J. 367, 383 (1994) (noting in the mass tort context that “[p]resent claimants have powerful psychological advantages over future claimants in their battle to maximize their share of the debtor’s estate. Present claimants in mass tort bankruptcies are identifiable persons with urgent medical and financial needs, while future claimants are only statistical probabilities.”).

\(^9\) The universe of plane crash victims, for example, is not limited to owners or passengers. It would therefore be impossible to identify, even in general terms, the class of persons who
only years after the business has been sold. A future claimant’s rights are considered only in retrospect—that is, when her injury occurs—if at all.

Consider the future claimant’s precarious position. The day of reckoning may have come and gone without her knowledge. She may not have known about the sale and dissolution. Even if she had known, she may have had absolutely no relationship or connection with the manufacturing firm at the time of sale. Even if she had had some connection—for example, as a consumer of its product—she may not have imagined that she could become an obligee of the manufacturer. She would not have been concerned about the day of reckoning or any possible effect of the sale and dissolution on her abstract legal rights. And even if she had understood in the abstract that her legal rights might be affected, she would not likely have taken any action. Given the remoteness of any possible injury, she would not have made a claim or invested resources to participate in any available legal process.¹⁰ As a practical matter, the future claimant will have had no opportunity to assert her rights and to be counted on

might ultimately suffer injury from a defective airplane. Similarly, the entire universe of individuals who have ever been exposed to asbestos fibers would also be difficult to capture, given the once pervasive use of asbestos as an insulating material in construction. See infra note 140 and accompanying text.

¹⁰ If at the time of sale and dissolution, an individual’s chances of ultimately sustaining injury are low, it may be difficult to convince her to invest resources today in a proceeding that will affect her, if ever, only years into the future. The expected value to any given individual of such an investment is likely negative, even if any ultimate injury might be severe. See Roe, Mass Tort, supra note 2, at 885 (“Individuals . . . often disregard serious risks that have a low probability of occurring.”); Alan Schwartz, Products Liability, Corporate Structure and Bankruptcy: Toxic Substances and the Remote Risk Relationship, 14 J. LEGAL STUD. 689, 725-26 (1985) (discussing disincentives for future claimants to trigger manufacturer’s bankruptcy). See also RICHARD B. SOBOL, BENDING THE LAW: THE STORY OF THE DALKON SHEILD BANKRUPTCY 107-115 (1991) (describing debate over whether notice to future claimants concerning claims bar date in bankruptcy could ever be adequate, given that future claimant in perfect health at time of notice would likely fail to appreciate its significance and
the day of reckoning.

Much may be at stake in whether unknown future tort creditors are compensated. The phenomenon of long-tail products liability is now commonplace.\(^1\) With modern design, engineering, and materials, many is the product that will stay in circulation long after its original manufacturer has sold its business and disappeared.\(^2\) And modern production and distribution enable widespread sale and use of a product long before harmful effects may become

\(^1\)See generally Green, Successors and CERCLA, supra note 4, at 904-06 (discussing long-tail products and environmental liabilities and inadequacy of traditional corporate law dissolution statutes in dealing with them); Kathryn R. Heidt, The Changing Paradigm of Debt, 72 Wash. U. L. Q. 1055 (1994) (describing “extraordinary liabilities” in bankruptcy) [hereinafter Heidt, Changing Paradigm]; Wendy E. Wagner, Choosing Ignorance in the Manufacture of Toxic Products, 82 CORNELL L. REV. 773 (1997) (describing dearth of even minimal level of safety research concerning long-term health effects of chemicals widely used in commerce, and incentives under current law for manufacturers not to perform such research but to build litigation defense strategies around ignorance).


Insurance industry statistics... suggest that only thirty percent of expected general liability claims (which include products liability) are reported three years after the initial policy year and only sixty percent are reported after the eighth year. Not until thirteen years after the initial policy year are seventy-five percent of the losses known to the insurer. The balance of these losses develop over the next two decades.

Id. at 1052 (citing REINSURANCE ASS’N OF AMERICA, LOSS DEVELOPMENT STUDY: 1985 EDITION 5 (1985)).
apparent to the public. There may have been a day when the possibility of future products liability claims caused little concern when a business was sold. Insignificant in terms of both number and severity, such future claims may simply not have been worth worrying about. That day, however, has passed.

Sales of businesses occur both within and outside of bankruptcy, and treatment of future claims is a difficult issue in both contexts. This Article focuses primarily on bankruptcy sales. It begins, however, with a discussion of the nonbankruptcy context and the common law doctrine of successor liability. This discussion provides background for the subsequent formulation of a prescription for treatment of future claims and related successor liability rights in bankruptcy.

Outside of bankruptcy, the rule of successor liability attempts to strike a rough accommodation of competing interests. When applicable, it allows the future claimant to recover from the acquirer if the manufacturer is unavailable. However, it is a doctrine of uncertain pedigree and uneven


When businesses purposefully conceal harmful effects after their discovery, the problem is of course exacerbated. See Paul Brodeur, Outrageous Misconduct: The Asbestos Industry on Trial (1985) (claiming that executives of Johns-Manville and other asbestos producers actively suppressed evidence of harmful effects of exposure); Sobol, supra note 10, at 1-22 (chronicling A.H. Robins' history of ignoring safety research showing dangers associated with use of Dalkon Shield); Wagner, supra note 11, at 823-24 (describing concealment of adverse safety testing results in marketing of breast implants and tobacco, as well as asbestos and Dalkon Shield).

14 Providing for future claimants' recoveries would have been relatively expensive when compared with the amount of accident costs that would otherwise have been left unsatisfied. Concerning the costs of successor liability, see infra note 65.
application. Its form and scope vary from state to state, rationales for its existence are confused, and it offers only sporadic relief to future claimants.\footnote{15 See infra Part II.}

The proper treatment of future claims in bankruptcy is likewise an unsettled question, both among courts and commentators. Courts have struggled over two fundamental issues: (i) whether a future claimant qualifies as a “creditor” whose rights may be affected by bankruptcy generally; and (ii) whether authority may be found in the Bankruptcy Code to extinguish future claimants’ successor liability rights following a bankruptcy sale. The confusion should not surprise. The courts have been left with the unenviable task of apportioning losses, both realized and remote, in the face of scarce resources and with little statutory guidance.

Unlike the courts, bankruptcy theorists agree on several fundamental points. They agree that future claims may appropriately be handled as part of the bankruptcy process—included as bankruptcy claims. Further, if the bankruptcy results in a sale of the business, then provided future claimants’ rights are recognized in bankruptcy, their successor liability rights should be extinguished.\footnote{16 See infra notes 238, 253-256 and accompanying text.}

However, theorists disagree as to the universality of the bankruptcy model. They disagree as to whether future claims must always be included in bankruptcy,\footnote{17 See infra note 127-129 and accompanying text.} or whether their inclusion should depend on the debtor’s
discretion—what I refer to as the “flexible” approach. Ironically, at a time when some scholars have called for fundamental corporate and commercial law reform to protect tort claimants from the liability avoidance that existing rules permit, certain bankruptcy commentators advocate a more instrumental approach, content to ignore future tort claims in bankruptcy if the needs of the debtor and current creditors so require.

This Article explains the proper disposition of future claims and future claimant’s successor liability rights when a business is sold in bankruptcy. My prescription has two components. First, I argue that in a bankruptcy proceeding through which a business is sold, future claims must be included and treated on a par with other unsecured creditors. Second, provided future claimants’ rights are thus recognized in bankruptcy, any related successor liability rights must be extinguished.

This Article makes three related contributions to the existing literature. First, I show that in the bankruptcy sale context, leaving to the debtor’s discretion the decision whether to include future claims merely enables future claimants’ exploitation. For the most part, neither advocates for the

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18 See infra notes 119-120 and accompanying text.

19 See infra note 294 and accompanying text. The approach advocated herein assumes the current state of corporate limited liability and creditor priority rules. This Article also takes no position with respect to the common law tort system as a method of setting and delivering compensation, but for present purposes takes the current system as given.

20 Future claims may also be included when the business is internally reorganized. However, a flexible approach may be acceptable in internal reorganization. See infra notes 185-186 and accompanying text. The sale context will be this Article’s primary focus, because it more strongly implicates liability avoidance concerns. See infra notes 187-188 and accompanying
flexible approach nor for mandatory inclusion of future claims have focused on the bankruptcy sale context and its exploitive potential.

Second, I clarify certain issues relating to the question of successor liability following a bankruptcy sale. As noted, courts disagree as to whether bankruptcy may extinguish future claimants’ successor liability rights. Bankruptcy theorists agree, however—and I with them—that bankruptcy should be able to do so. The confusion among courts I attribute to a misapprehension concerning the proper rationale for successor liability. Relying on a cost internalization rationale—an approach endorsed by the weight of corporate and tort law scholarship—I explain the proper relationship between successor liability and bankruptcy. I show that as long as future claimants’ rights are recognized in the bankruptcy proceeding, successor liability is unnecessary as a device to force the debtor’s cost internalization. While bankruptcy scholars note the unacceptable bankruptcy consequences of successor liability following a bankruptcy sale, I take successor liability on its own terms to reach a similar conclusion as they. As long as future claimants share equally with other creditors in the bankruptcy distribution, then not only is successor liability counterproductive from a bankruptcy perspective, but properly conceived, it is unnecessary under its own rationale.

Finally, I tackle practical implications of the scheme I advocate. Recognizing that for many debtors, the current “traditional” approach to treatment of future claims—pioneered in the mass tort bankruptcies—may
generate transaction costs disproportionate to the amounts at stake, I introduce an approach I call Commensurate Discounted Assumption (“CDA”), in which the acquirer assumes at a discount the debtor’s liability for future claims. This approach sidesteps the uncertainty of the formal estimation that is critical to the traditional approach and avoids some of the costs of that approach.

In Part II, I discuss the successor liability doctrine, the cost internalization approach and implications of this approach for financial distress situations. In Part III, I introduce bankruptcy into the discussion, describing the framework for corporate reorganization. In Part IV, I discuss inclusion of future claims in reorganization. I describe the mass tort cases, in which future claims have been included, and contrast them with ordinary cases, in which future claims are typically ignored. I discuss the impetus behind the flexible approach and criticize its application to the bankruptcy sale context. In Part V, I describe the bankruptcy power to extinguish successor liability claims, and I explain why successor liability is unnecessary following bankruptcy. In Part VI, I comment on the practical implications of the scheme I advocate and discuss possible approaches, including CDA.
II. Successor Liability

Sometimes when a business fails, creditors go unpaid. Our system of limited shareholder liability assures that.\textsuperscript{21} We may be less concerned when those creditors are voluntary creditors than when they are involuntary creditors. Contract creditors have opportunities to assess the risk of nonpayment. They can adjust through interest rate charges and by diversifying their portfolios.\textsuperscript{22} However, for involuntary creditors life is tougher. Tort victims in particular do not set interest rates on their injuries. They cannot strategically spread their “credit” across multiple companies or industries in an attempt to diversify. They are the creditors least able to adjust to the risk of nonpayment.\textsuperscript{23}

Of these, future tort claimants are in the worst position. Not only are they unable to adjust for default risk, but they are also vulnerable to corporate tortfeasors’ liability avoidance strategies. The tortfeasor may sell its

\textsuperscript{21} See generally Robert Charles Clark, Corporate Law (1986), § 1.2.1 at 7-10 (describing functions of limited investor liability).


\textsuperscript{23} See Reinier H. Kraakman, Corporate Liability Strategies and the Costs of Legal Controls, 93 Yale L.J. 857, 870 (1984) (“[T]ort victims . . . cannot protect themselves by refusing the firm ‘credit’ or by demanding a security interest in firm property before accidents.”).
business, either inside bankruptcy or outside. In either case, the sale has the potential to preclude future claimants from recovery while benefiting other interested parties.

This Part discusses future claimants’ predicament in the nonbankruptcy situation. Successor liability is a judicially created doctrine meant to address this problem. The next Part describes the sale of a business in the context of bankruptcy reorganization.

A. *Form and Substance in the Sale of a Business*

Corporations buy and sell businesses as a normal part of their economic activities. The structuring of a given sale transaction has important consequences for creditors, shareholders and other stakeholders of both buying and selling companies,24 as well as for the public fisc.25 The two standard and contrasting models for corporate acquisition are the merger and the sale of assets.

1. *Merger v. Asset Sale*

The merger device provides a neat and tidy “off the rack” method of acquisition that tends to minimize disruption of the existing legal and other

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relationships of the corporations involved.26 In the standard merger, the
acquiring company pays consideration to the shareholders of the target company
in exchange for the target’s business, and the target company merges into the
acquirer. The acquirer as the surviving entity succeeds to the assets and
liabilities of the target by operation of law.27 The legal existence of the target
company ends as a result of the merger, but the surviving company remains
liable to the target’s creditors.28

The tidiness of this arrangement presents drawbacks, however, if
the acquirer wishes to be selective about which assets of the target it will acquire
or which liabilities it will assume. If the acquirer wants the lock and stock but
not the barrel, then an asset sale may be the preferred acquisition technique. The
acquirer purchases selected assets from—and may assume particular liabilities
of—the target. This technique may be useful in enabling the acquirer to avoid,

26 See RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATION
ACQUISITIONS 642 (2d ed. 1995).

At one moment two corporations exist; at the next, the acquiring corporation has
enveloped the target, like an amoeba engulfing its prey, and has succeeded to all of its
properties, rights and other attributes. The technique has significant advantages in
reducing the transaction costs associated with the mechanical aspects of accomplishing
an acquisition. . . . The effect of statutory [merger] provisions . . . is to substitute a
single document, the merger agreement, for the flood of papers that would otherwise be
required to effect the transaction.

Id.

27 See, e.g., MODEL BUS. CORP. ACT § 1106(a)(3) (1994); DEL. CODE ANN. tit. 8, § 259(a)
(1997); CAL. CORP. CODE § 1107 (West 1990).

28 “A statutory merger provides the most protection. . . . [C]reditors of the target company are
protected because the surviving company in a merger assumes as a matter of law all of the
target’s liabilities, including unknown or contingent liabilities.” GILSON & BLACK, supra
note 26, at 1503.
or at least minimize, exposure to certain of the target’s creditors, an option not available under merger.

When the acquirer buys the assets of its target, generally only the assets transfer. The liabilities do not automatically follow. The acquirer, a legal entity separate and distinct from the target, does not succeed to the target’s liabilities absent specific agreement otherwise. As a matter of economic substance, a business enterprise may be transferred, but the liabilities associated with that business remain with the target firm, absent some exception to this general rule.

By itself, the asset sale does nothing to prejudice the target’s creditors. As long as the target entity receives fair consideration for its assets and remains in existence to answer for its liabilities, creditors of the target have nothing to fear. However, once a target entity sells its business, it typically will dissolve. With no business left to operate, the target entity has no further reason to exist. Because it is left with only the sale consideration—usually cash, marketable securities, or some combination—the target will dissolve, paying its known creditors and distributing remaining assets to its shareholders.

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29 Mergers also implicate shareholder consent requirements and other protections, which may give corporate planners further incentive to avoid mergers in favor of asset sales. *Id.*

30 *Id.*

31 As Professor Carlson has noted, “[C]orporate lawyers soon learned that by avoiding mergers and substituting sales of assets instead, the assets of a debtor might be laundered and its creditors’ claims against the buyer effectively eliminated.” David Gray Carlson, *Successor Liability in Bankruptcy: Some Unifying Themes of Intertemporal Creditor Priorities Created by Running Covenants, Products Liability, and Toxic-Waste Cleanup*, 50 LAW & CONTEMP. PROBS. 119, 127 (1987). With respect to exceptions to the general rule, *see infra* Part II.B.
The typical state corporation statute requires only that the
dissolving corporation pay or provide for its known debts as a condition to
dissolution.\textsuperscript{32} Unknown claims at the time of dissolution—in particular, future
products liability claims—may be prejudiced by the dissolution.\textsuperscript{33} The corporate
tortfeasor has disappeared, and the shareholders who received the corporation’s
surplus are largely immune to suit. While states generally provide a
postdissolution period within which suit may be brought,\textsuperscript{34} and shareholders may
be required to disgorge postdissolution distributions in satisfaction of such suits,
this liability is typically limited. A shareholder will be liable only for the \textit{lesser}
of (i) the amount of any distribution received and (ii) her pro rata share of the


\textsuperscript{33} Claims that have not arisen under state law at the time of dissolution are generally not
considered known debts. \textit{See} Penasquitos, Inc. \textit{v.} Superior Court, 812 P. 2d 154 (Cal. 1991)
(“[A] claim that is contingent or has not matured so that there is no immediate right to bring
suit is not a ‘known’ claim.”).

\textsuperscript{34} \textit{See, e.g.}, \textit{Del. Code Ann.} tit. 8, § 278 (1997) (three years); \textit{Cal. Corp. Code} § 2011(a)
that for unknown claim, suit be brought within five years from date of publication notice of
dissolution).

Delaware now provides incrementally more protection for unknown creditors. Upon
dissolution, provision must be made which will “be reasonably likely to be sufficient” to
compensate unknown claims which “based on facts known to the corporation . . . are likely to
arise or to become known . . . within 10 years after the date of dissolution.” \textit{Del. Code Ann.}
tit. 8, § 281(b) (1997). The dissolved corporation may during the winding up process petition
the Chancery Court for a determination concerning the proper amount and form of security to
satisfy the above prescription. The court determination process also holds out the possibility of
shortening the “tail” period to 5 years. \textit{Id.} at § 280(c)(3). The court may also appoint a
guardian ad litem to represent unknown claimants, with the guardian’s reasonable fees and
expenses paid by the petitioning corporation. \textit{Id. See also In re RegO Co.}, 623 A.2d 92 (Del.
Ch. 1992) (deciding first case challenging dissolution plan under predecessor to current
statute).

Even an extended tail period, however, may prove ineffective to provide substantial
coverage for future products liability claimants. \textit{See supra} notes 12-13 and accompanying text.
late-appearing creditor’s claim. This limitation, along with the costs of pursuing individual shareholders—locating them, fighting possible jurisdictional issues, judgment-proof defendants—makes this an unattractive prospect for future tort victims.

Among the target corporation’s creditors, future tort victims are peculiarly vulnerable to corporate liability avoidance through dissolution. Traditional lenders, like banks and bondholders, protect themselves through security agreements and/or negative covenants negotiated as part of their consensual lending transactions. Such lenders typically negotiate for veto power over major corporate changes like substantial asset sales. In addition to contractual protection, these creditors are known creditors at the time of any dissolution. State law generally requires that they be paid before any distribution to shareholders.


37 See American Bar Foundation, Commentaries on Model Debenture Indenture Provisions 290-301 (1971). The debtor-borrower willingly provides such protection to the lender in order to reduce its borrowing costs. Higher risk to the lender would result in a higher interest charge to the borrower. A lender’s contractual veto over significant future transactions that might otherwise disadvantage it reduces its risks, resulting in a corresponding reduction in interest rate. The incremental costs of contracting for and monitoring this type of protection are also likely to be low. The contracting occurs as part of the overall loan negotiation, and the monitoring is simply an additional aspect of the lender’s overall monitoring effort during the life of the loan.

38 These creditors can also protect themselves in the market. They can diversify their loan portfolios to minimize the impact of a loss on any particular investment. See supra note 22 and accompanying text.
Trade creditors and manifested tort victims will also be known creditors at the time of dissolution. State dissolution law will therefore protect them even though they lack the elaborate contractual protections that banks and bondholders enjoy. Trade creditors typically do not negotiate for these protections, and tort victims of course cannot.

By contrast, the future tort claimant cannot protect herself from this sale-and-dissolution strategy. She has no avenue for negotiating protective covenants, since her claim is not based in contract. She is not known at the time of dissolution, so she falls outside the class of creditors protected by state dissolution laws. She is in no position to diversify away the risk of the manufacturer's dissolution.

In any particular enterprise, the aggregate amount of future tort liability may be large enough to worry about. Therefore, in structuring these types of transactions, purchasers and sellers have incentive to avoid future liabilities. Even absent opportunism on the part of purchasers and sellers, the

39 “The costs of contracting and monitoring are too high given the typical size of the debt and the character of the creditor.” Gilson & Black, supra note 26, at 1504. As for risk generally, trade creditors are at least theoretically better situated to diversify away risk than are tort victims, though both may be subject to debtors’ liability-avoidance strategies. See generally Bebchuk & Fried, supra note 23; LoPucki, The Unsecured Creditor’s Bargain, supra note 23 (arguing that because security interest enables secured creditor and debtor to extract subsidy from unsecured creditors, both voluntary and involuntary, involuntary creditors should enjoy priority over secured creditors, and voluntary unsecured creditors should be only conditionally subordinated to secured creditors).

40 The existence of such incentives will of course vary from industry to industry, depending on the tort generating potential of the business. See, e.g., George L. Priest, The Current Insurance Crisis and Modern Tort Law, 96 Yale L.J. 1521 (1987) (identifying particular industries and products—vaccines, general aviation aircraft, sports equipment and ski lift operations, among others—subject either to drastically rising insurance premiums or unavailability of coverage at any price); Lynn M. LoPucki, The Death of Liability, 106 Yale L.J. 1, 44-45 (1996) [hereinafter LoPucki, The Death of Liability] (discussing varying incentives to judgment-proof
pervasiveness of long-tail liabilities suggests that the aggregate liability-avoiding
effects of corporate dissolution may be significant.

2. **Loss Distribution**

The distribution of losses from future products liability will turn on
the form of the acquisition. With a merger, because the acquirer is liable for
future tort claims as a matter of law, it will attempt to discount the merger
consideration by the amount of anticipated future liabilities. It will demand a
discount for having to answer for future injuries caused by products already
manufactured by the target. The outcome of this negotiation effectively divides
the losses between the acquirer and the target’s shareholders. And future tort
victims may recover from the acquirer as their claims mature.

In the alternative, the acquirer and target may cooperate to leave
future products liability losses with the victims. Structuring the transaction as an
asset sale, followed by dissolution of the target, effectively wipes out the future
claims, allowing the acquirer and the target’s shareholders to share the gains
from this cost avoidance. As with the sharing of losses in the merger context,

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41 This assumes the absence of any rule of successor liability.

42 In contrast to the merger scenario, the acquirer would not demand a discount for future
liabilities, but would be willing to pay something approaching "full" price, since absent
successor liability, it buys only assets, leaving all liabilities with the seller. Under this
scenario, the acquisition costs the acquirer no more overall, and perhaps less, than if the future
claims could not be eliminated. The increased price for the assets is more than offset by the
freedom from future liabilities the acquirer would have had to assume in the merger context.

This asset sale strategy is akin to other corporate cost externalization strategies, which
likewise rely on the law’s general respect for the separateness of corporate entities. As
Professor LoPucki reminds us, “the liability system looks first to the entity structure

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the sharing of gains in the asset sale context is not explicitly memorialized between acquirer and target, but is determined implicitly through the parties’ bargaining over the purchase price. It also does not depend on the parties’ intent. There may be many reasons why acquirer and target might prefer an asset sale to a merger that have nothing to do with eliminating future claims. Nevertheless, the negative consequences to future tort victims remain the same.

B. The Successor Liability Doctrine

Into this breach stepped the courts, or at least some of them. Over time, courts developed enterprise-based approaches to address liability avoidance through asset sale, crafting exceptions to the basic rule that the acquirer of assets does not inherit the target’s liabilities. These exceptions, the “business continuation” exception and the “product line” exception, allow suit against the

established by the strategist.” LoPucki, The Death of Liability, supra note 40, at 67 (describing judgment-proofing strategies and possible responses of the legal system). Unlike asset securitization or strategic use of fragmented incorporation to isolate assets from risks, where entities are, at least at some point, conventional affiliates under common control, see id. at 19-30 (describing “ownership strategies” of judgment-proofing), acquirer and seller in our discussion are assumed to be independent entities. They are merely affiliates in time, in the sense that one succeeds to the enterprise of the other. Moreover, one could think of successor liability as a sort of intertemporal veil piercing.

43 Courts have been willing under some circumstances to view enterprises rather than entities as the operative units for imposition of liability. See Phillip I. Blumberg, The Law of Corporate Groups: Bankruptcy Law § 18.02 at 699-704 (1985)(describing with approval evolution from entity principles to enterprise principles in many areas of law); Phillip I. Blumberg, The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities, 28 Conn. L. Rev. 295, 344 (citing development of successor liability law as example of growing application of enterprise principles in American law). However, as with other entity-based liability-avoiding strategies, the law will disregard entities only in “extreme circumstances.” LoPucki, The Death of Liability, supra note 40, at 67.

44 Other exceptions to the general rule of nonliability of the asset acquirer have been recognized where the asset sale is deemed a fraudulent attempt to evade creditors, where the purchasing corporation is a mere continuation of the selling corporation, or where the acquirer agrees, either explicitly or implicitly, to assume the target’s liabilities. See Knapp v. North
acquirer by the claimant, unknown at the time of the acquisition, who suffers injury from a product manufactured by the target—that is, the predecessor owner. In this way, a means of recovery is provided to the future claimant.

1. The Business Continuation Exception

Under the business continuation exception, the acquirer inherits the target’s future tort liabilities if there is economic continuity of the enterprise in the acquirer’s hands. Structuring the transaction as an asset sale, as opposed to

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Our focus is on the difficult case, that of the bona fide arms'-length enterprise sale between unaffiliated parties where the acquirer does not agree to assume future tort liabilities.

45 The terms “predecessor,” “manufacturer,” and “target” are used interchangeably, depending on the context, to refer to the entity that manufactured the product that later causes harm to the future claimant.

46 See e.g., Turner v. Bituminous Casualty Co., 244 N.W. 2d 873, 881-84 (Mich. 1976); Cyr v. B. Offen & Co., 501 F.2d 1145, 1153 (1st Cir.1974) (interpreting New Hampshire law), criticized by Simoneau v. South Bend Lathe, Inc., 543 A.2d 407, 408-09 (N.H. 1988) (rejecting Cyr interpretation of New Hampshire law, since New Hampshire does not recognize risk spreading as a basis for strict liability or successor liability). In Turner, the court enumerated four requirements for the business continuation exception: (1) basic continuity of the enterprise, including retention of key personnel, assets, general business operations, and the predecessor’s name; (2) the predecessor’s dissolution soon after its distribution of the sale proceeds; (3) the acquirer’s assumption of the liabilities and obligations necessary for the continuation of ordinary business operations; and (4) the acquirer’s holding itself out to the public as the predecessor. Turner, 244 N.W. 2d. at 883-84.

This exception grew out of the de facto merger doctrine of corporate law, in which the primary focus was shareholder protection. Whereas statutory mergers typically require approval by shareholders of the constituent corporations and provide dissenters’ rights, corporate planners attempted to avoid these protections by structuring business combinations as asset sales instead. The acquirer would issue its own stock as consideration for the target’s assets. The target would then dissolve, distributing this consideration to its own shareholders. As a result, the acquirer swallowed the target’s business, and the target’s former shareholders became shareholders of the acquirer. Because the end result was the same as a stock merger, courts created the doctrine of de facto merger in order to afford the acquirer’s shareholders the
a merger or stock sale,\textsuperscript{47} will not eliminate these liabilities. Continuity of the business means that the substantive effect of the sale is simply to change ownership of the business.\textsuperscript{48} Successor liability ensures that the business in the hands of the new owner is subject to the same future tort liabilities as it would have been under the continued proprietorship of the former owner.

In the seminal case of \textit{Turner v. Bituminous Casualty Co.},\textsuperscript{49} the court could find no substantive difference between a traditional merger, a de

same protections to which they would have been entitled in the case of a statutory merger. \textit{See}, \textit{e.g.}, \textit{Farris v. Glen Alden Corp.}, 143 A.2d 25 (Pa. 1958). Courts then imported this approach into the tort area, deeming certain business combinations the functional equivalent of statutory mergers, such that the acquirer should succeed to the target’s future tort liabilities. \textit{See Knapp v. North American Rockwell Corp.}, 506 F.2d 361 (3d Cir. 1974 ), \textit{cert. denied}, 421 U.S. 965 (1975) (discussing corporate law genesis of de facto merger doctrine, and imposing successor liability in stock-for-assets acquisition). From there, it was a relatively small step to the conclusion that in the tort context, the merger analogy should apply regardless of whether the sale consideration is stock or cash. \textit{Turner}, 244 N.W. 2d 873. \textit{See generally} \textit{Green, Statutory Reform}, \textit{supra} note 44, 22-26 (describing common law development of successor liability), and sources cited therein.

This concept is often stated as two distinct exceptions to the general rule of nonliability—“business continuation” and “de facto merger.” However, the exceptions tend to overlap. “[N]o criteria can be identified that distinguish them in any useful manner. In each instance, the central issue is whether the purchasing corporation effectively has become the selling corporation by acquiring not only the latter’s assets but also its entire business.” \textit{J. Phillips, Product Line Continuity}, \textit{supra} note 44, at 909 (1983). \textit{See also} \textit{Note, Products Liability of Successor Corporations: A Policy Analysis}, 58 \textit{Ind. L.J.} 677, 699-700 (1983)(noting substantial overlap between de facto merger and continuation theories).

\textsuperscript{47} With a sale of stock, although the identity of the owners changes, the corporate form of the business remains unchanged, unlike the case of acquisition by merger or asset sale. Therefore, the sale of stock does not affect the liabilities of the subject corporation.

\textsuperscript{48} Among other factors courts have used to determine enterprise continuity are continuity of management and other employees, retention of the same production facilities in the same physical location, continuity of assets, retention of the same name and product, continuity of general business operations, and the acquirer’s purchase of the predecessor’s goodwill. \textit{See e.g.}, \textit{MacCleery v. T.S.S. Retail Corp.}, 882 F. Supp. 13, 17 (D.N.H. 1994); \textit{Cyr v. B. Offen & Co.}, 501 F.2d 1145, 1153 (1st Cir. 1974); \textit{Shannon v. Samuel Langston Co.}, 379 F. Supp 797 (W.D. Mich. 1974). \textit{See also} \textit{J. Phillips, Product Line Continuity, supra} note 44, at 918-919.

\textsuperscript{49} \textit{Turner}, 244 N.W. 2d 873.
facto merger,\textsuperscript{50} and the cash sale of assets that was the subject of the case. From the tort victim’s perspective, “distinctions between types of corporate transfers are wholly unmeaningful.”\textsuperscript{51} Her problem is the same, regardless of the form of the transaction. Once the predecessor dissolves, the injured party has only the successor to look to for recovery.

The court concluded that the problem presented was one of tort law, requiring the application of products liability principles rather than reexamination and adjustment of corporate law rules.

This case has nothing to do with . . . the technical differences between a sale of assets . . . , mergers, consolidation . . . and the many other ways by which ownership of the . . . manufacturing enterprise could have been transferred. . . . The issue is, rather, one of tort law: does a manufacturer’s responsibility for its defective products survive a change in ownership, where the manufacturing business, as such, maintains its identity and continues to operate as before “at the same old stand.”\textsuperscript{52}

Because of the continuity of the business in the acquirer’s hands and the acquirer’s representing itself as the original manufacturer, the manufacturer’s strict products liability must be borne by the acquirer.\textsuperscript{53}

\textsuperscript{50} See supra note 46.

\textsuperscript{51} Turner, 244 N.W. 2d at 878.

\textsuperscript{52} Turner, 244 N.W. 2d at 880 (quoting Ray v. Alad, 127 Cal. Rptr. 817, 819-20 (Cal. Ct. App. 1976), superseded by Ray v. Alad, 560 P. 2d 3 (Cal. 1977)).

\textsuperscript{53} “Justice would be offended if a corporation which holds itself out as a particular company for the purpose of sales, would not be estopped from denying that it is that company for the purpose of determining products liability.” Turner, 244 N.W. 2d at 882. See also Cyr v. B. Offen & Co., 501 F.2d 1145 (1st Cir. 1974): The very existence of strict liability for manufacturers implies a basic judgment that the hazards of predicting and insuring for risk from defective products are better borne by the manufacturer than by the consumer. The manufacturer’s successor, carrying over the experience and expertise of the manufacturer, is likewise in a better position than the consumer to gauge the risks and the costs of meeting them. The successor knows
2. *The Product Line Exception*

Related to the business continuation exception is the product line exception. First adopted in California in the famous decision of *Ray v. Alad*, this theory of successor liability turns on the acquirer’s continuation of the target’s product line—its “undertaking to manufacture essentially the same line of products as the predecessor”—and not on continuity of the business as such.

While *Ray*’s facts may have supported successor liability under a business continuation theory, the *Ray* court refused to rely on the available corporate law stemma. Instead, the court looked directly to the policies underlying strict products liability. It offered three justifications: (i) the unavailability to plaintiff of an adequate remedy against the manufacturer because of the successor’s acquisition of the business and the manufacturer’s subsequent liquidation; (ii) the successor’s ability to assume the original manufacturer’s loss spreading role by virtue of its ability to gauge the risks of the product, is as able to calculate the risk of defects as the predecessor, is in position to insure therefor and reflect such cost in sale negotiations, and is the only entity capable of improving the quality of the product.

*Id.* at 1153-54.


56 The acquirer purchased all tangible assets. Factory personnel remained the same. The predecessor’s general manager was retained as a consultant by the acquirer for six months after the acquisition, since none of the acquirer’s employees knew how to make the ladders which were the product of the enterprise. The acquirer used the predecessor’s trade name and customer lists, and customers were not made aware of the new ownership of the business. The terms of the transaction required the predecessor’s dissolution following the sale. *Ray v. Alad*, 560 P.2d at 5-6. Moreover, the court suggested that *Cyr* continuity factors were present. *Id.* at 8.
injury from previously manufactured products and to meet the costs of injuries by spreading such costs among current purchasers of the product; and (iii) the fairness of requiring the successor to assume responsibility for defective products, which was a burden necessarily attaching to the benefits of the original manufacturer’s goodwill enjoyed by the successor in its continuation of the business.\textsuperscript{57}

In this analysis, such factors as continuity of management, personnel, or ownership are not significant.\textsuperscript{58} What is significant is the acquirer’s ability to assume the manufacturer’s loss spreading role.

\textit{[T]he acquisition of the . . . enterprise gave \{the successor\} the opportunity formerly enjoyed by \{the predecessor\} of passing on to purchasers of new . . . products the costs of meeting these risks. Immediately after the takeover it was \{the successor\}, not \{the predecessor\}, which was in a position to promote the “paramount policy” of the strict products liability rule by “spreading throughout society . . . the cost of compensating [otherwise defenseless victims of manufacturing defects]”}.\textsuperscript{59}

As a practical matter, the business continuation and product line exceptions overlap to a fair degree. The acquirer wishing to manufacture the predecessor’s product line will typically purchase both tangible and intangible

\textsuperscript{57} Ray, 560 P.2d at 5. The court in addition noted that imposition of successor liability precludes the original manufacturer from enjoying a windfall from its sale-and-dissolution strategy, which would otherwise enable it to reap an “enhanced price” for the business free of future tort liabilities and then avoid responsibility for subsequent injuries by liquidating. \textit{Id.} at 11.

\textsuperscript{58} Ray, 560 P.2d at 8; Ramirez, 431 A.2d at 819.

assets of the predecessor. It will avail itself of the predecessor’s goodwill and trade names. Key personnel and other employees of the predecessor will typically continue with the new owner. The two tests differ merely as to emphasis. Each refers to separate indicia to determine whether there is economic continuity sufficient to justify imputation of the predecessor’s future tort liabilities to the enterprise in the acquirer’s hands. The business continuation theory adopts a sort of totality of circumstances test. The court must weigh a laundry list of factors to decide whether the requisite overall continuity threshold is met. The product line theory, by contrast, looks to continuation of the product line as the barometer of economic continuity.

C. Assessing Successor Liability

Although successor liability provides compensation to otherwise hapless future tort claimants, it has generated much controversy as to both its theoretical justifications and its practical consequences. With respect to the latter, it admittedly raises the costs of transferring assets and may force piecemeal liquidation of going concerns. Even defenders of the doctrine note

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61 “By taking over and continuing the established business of producing and distributing [the predecessor’s] ladders, [the successor] became an integral part of the overall producing and marketing enterprise that should bear the cost of injuries resulting from defective products.” Ray, 560 P.2d at 11 (internal quotes omitted).

62 The costs of estimating future liabilities and any uncertainty with respect to such estimates will deter prospective acquirers.

The potential imposition of unwanted liability is likely to complicate bargaining and
its shortcomings. Only a minority of courts have been willing to follow *Turner* and/or *Ray*.

Putting aside the question whether the costs of the rule exceed its benefits—which is ultimately an empirical issue that may not be susceptible of easy assessment—in this section, we consider the controversy over the rule’s raise transaction costs by requiring the buyer to investigate carefully the future liability it may face. Indeed, the threat of successor liability may cause some negotiations to fail when, for example, the seller’s records of products extant prove incomplete and the buyer cannot make a reasonable estimate of the costs that it would face.

Steven H. Schulman, *Commentary: Successor Corporation Liability and the Inadequacy of the Product Line Continuity Approach*, 31 WAYNE L. REV. 135, 142 (1984). See also Roe, *Successor Liability, supra* note 36, at 1561 (noting that successor liability might result in "assets [being] caged in the hands of a demoralized and disabled management that is unable to sell its operations to a higher-valuing and perhaps more capable user."). Moreover, if the present value of future tort liabilities exceeds the operational value of the business, it will be unmarketable as a going concern at any price. See *id.* at 1568.

On the other hand, even without the added risk of successor liability, uncertainty concerning product safety may block any deal, since the acquirer will be liable for products of its own post-acquisition manufacture in any event.

In addition to the problem of finding a buyer, successor liability may create problems of strategic behavior by shareholders, who under state law must approve the corporation’s sale of all its assets. See, e.g., MODEL BUS. CORP. ACT § 12.02 (1994). Shareholders may push for piecemeal liquidation when liquidation proceeds would exceed those realizable from a going concern sale. The going-concern acquirer will discount its offering price to account for successor liability risk. See *infra* notes 73-75 and accompanying text. If this discount is greater than the value of the goodwill of the business—that is, the difference between its going concern value and scrap value—then a piecemeal liquidation will net shareholders more than a going concern sale.

63 See Green, *Statutory Reform, supra* note 44, at 41-49 (advocating dissolution-restricting statute as superior alternative to successor liability on numerous grounds).

64 See Green, *Successors and CERCLA, supra* note 4, at 908-10 (chronicling the “emergence and demise” of liberal successor products liability doctrine, and noting that (i) only four state supreme courts have adopted liberal successor liability rules, (ii) six state supreme courts rejected the same between 1985 and 1988, and (iii) “virtually every other state court encountering the issue declined to adopt a liberal successor liability rule.”).

65 Judge Posner describes the problem as one of comparing costs; in particular, comparing (a) the transaction costs that would be visited upon sales of businesses as a result of imposition of successor liability with (b) the accident costs externalized under a rule of no successor liability. The traditional corporate law rule of no successor liability “reflects a time when delayed tort consequences were less common than they are today, so that the transaction costs
raison d’être. Identifying the proper rationale for successor liability has important implications for its applicability to situations of financial distress.

1. **The Proper Rationale: Cost Internalization**

The courts adopting a rule of successor liability rely primarily on a loss spreading justification. The analyses in *Turner, Ray* and their progeny focus primarily on the successor-acquirer. That is, provided the requisite continuity exists, the rationales for strict products liability of the manufacturer apply also to the acquirer. The primary argument in this vein, as *Ray* noted, is that the successor can assume the manufacturer’s loss spreading role. The successor can spread the costs of injuries among its customers through the pricing of the product.

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66 *See* J. Phillips, *Product Line Continuity, supra* note 44, at 909 (viewing the major area of controversy concerning successor liability to be the question of the requisite degree of continuity which will justify imposition of successor liability: “whether the purchasing corporation effectively has become the selling corporation by acquiring not only the latter’s assets but also its entire business.”).

67 *See supra* note 59 and accompanying text.

To be sure, courts espousing the *Turner/Ray* strict liability approach mention other justifications besides the acquirer’s ex post loss spreading role. They also acknowledge the ex ante effects on the acquirer of successor liability risk. The acquirer may be able to negotiate indemnification from the predecessor, adjust its purchase price, devise escrow arrangements to fund any losses from future product liability claims, or insure. *See* Ramirez, 431 A.2d at 822-23. These arguments, however, have not been central to the strict liability approach of *Turner* and *Ray*. The primary emphasis has been on loss spreading. *See* David Morris Phillips, *Products Liability of Successor Corporations: A Corporate and Commercial Law Perspective*, 11 Hofstra L. Rev. 249, 253 (1982) (noting the courts’ emphasis on the successor’s ability to spread the costs of accidents among consumers).

Courts have also relied upon a type of “bitter with the sweet” argument. Continuity of the business permits the acquirer to exploit the good will accumulated by the seller: to hold itself out as the predecessor manufacturer and to enjoy the continued patronage of the predecessor’s customers. *See, e.g.*, Wilkerson v. C.O. Porter Mach. Co., 567 A.2d 598, 601
But this reasoning is problematic. It too glibly assigns the manufacturer’s strict liability to the acquirer.\textsuperscript{68} Once the manufacturer becomes unavailable to answer for injuries associated with products of its manufacture, the loss spreading rationale does not unambiguously identify the acquirer as the proper loss spreading entity. While the successor may be in a better position than the consumer to bear risk and spread losses, so are the government and many other business entities and wealthy individuals. The ex post loss spreading rationale fails to distinguish the acquirer from any readily available deep pocket.\textsuperscript{69}

Moreover, even the manufacturer’s strict liability is not premised merely on its ability to spread losses,\textsuperscript{70} but also on the idea of tort deterrence. The manufacturer is the cheapest cost avoider. It is uniquely situated to perform

\begin{itemize}
\item While this “bitter with the sweet” rationale may have superficial appeal, it fails to recognize that the acquirer already took the bitter with the sweet by paying for the predecessor’s goodwill. It did not receive the predecessor’s goodwill—the sweet—as a gift but was required to pay for it—the bitter. And the sweeter the goodwill, the higher the price. Subsequent accidents not only do not benefit the acquirer but reduce the value of an important asset it now owns. Unless the acquirer received some discount for agreeing to assume the predecessor’s liabilities—a condition that has not been articulated as part of this rationale—adding successor liability to the price tag in effect forces the acquirer to pay twice. \textit{See} Green, \textit{Statutory Reform, supra} note 44, at 29; GILSON & BLACK, \textit{supra} note 26, at 1531; Schulman, \textit{supra} note 62, at 136.

\textsuperscript{68} \textit{See} Green, \textit{Statutory Reform, supra} note 44, 28-40 (criticizing rationales for successor liability focused on acquirer’s role); GILSON & BLACK, \textit{supra} note 26, at 1530-32 (same).

\textsuperscript{69} \textit{See} Green, \textit{Statutory Reform, supra} note 44, at 30-31; D. Phillips, \textit{supra} note 67, at 251-52, 254.

\textsuperscript{70} Cf. Gary T. Schwartz, \textit{The Ethics and the Economics of Tort Liability Insurance}, 75 Cornell L. Rev. 313, 359-62 (questioning whether loss spreading is or ought to be an objective of tort
the cost calculus necessary to decide upon cost-justified safety measures. By contrast, the acquirer cannot ordinarily make decisions retroactively affecting the safety of the predecessor’s products. Wooden application to the acquirer of the standard rationales for the manufacturer’s strict liability seem inadequate justification for successor liability.

In contrast to the courts, commentators have argued convincingly that cost internalization is successor liability’s most persuasive rationale.

Responding to the prospect of successor liability, the acquirer will discount its

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71 See Guido Calabresi, The Costs of Accidents 135-40 (1970) (describing role of cheapest cost avoider in general deterrence scheme); Guido Calabresi and Jon T. Hirschoff, Toward a Test for Strict Liability in Torts, 81 Yale L.J. 1055, 1060 (1972) (asserting that placing liability on cheapest cost avoider, that is, party to accident that “is in the best position to make the cost-benefit analysis between accident costs and accident avoidance costs and to act on that decision once made,” is preferable to having judge or jury second-guess injurer’s actual cost-benefit analysis) (emphasis supplied).

72 Cf. Ramirez, 431 A.2d at 821 (finding that the successor is in a better position than the injured party to bear accident-avoidance costs). Presumably, the acquirer’s liability for products of its own manufacture would be sufficient incentive for it to take appropriate safety measures with respect to such products, whose safety features are within its control, unlike the predecessor’s products. See Green, Statutory Reform, supra note 44, at 35-36.

In some circumstances, the acquirer may have an independent duty to warn of risk created by the predecessor’s product if the acquirer has a substantial continuing relationship with the predecessor’s customer. See Restatement (Third) of Torts: Products Liability § 13 (1998).

73 See Gilson & Black, supra note 26, at 1534 (describing cost internalization via bargain over acquisition price); Green, Statutory Reform, supra note 44, at 21 (describing successor as conduit for passing liability to predecessor); D. Phillips, supra note 67, at 262-63 (noting that predecessor could compensate successor for assuming future liabilities through reduced purchase price, and that successor is an active participant in scheme to externalize losses); Roe, Successor Liability, supra note 36, at 1566-68 (discussing cost internalizing effect of acquirer’s discount when liability is predictable and less than operational value of firm); Schulman, supra note 62, at 139 (“When the law compels the buyer to face responsibility for claims that otherwise effectively would be foreclosed in dissolution, the buyer will respond appropriately to assure that the projected burden falls upon the seller and its shareholders.”); Schwartz, supra note 10, at 715-716 (discussing cost internalization).
purchase price for the business, based on its estimate of future claims liability.\textsuperscript{74} This “successor liability discount” reduces sale consideration to the manufacturer, effectively passing the costs of future injuries from the acquirer to the manufacturer. The manufacturer is thereby forced to internalize these costs. Successor liability in effect creates an implied-in-law term of the acquisition transaction. It mandates assumption of the manufacturer’s future tort liabilities by the acquirer. Anticipating this implied term of the deal, the acquirer will reduce its bid price, and the manufacturer absorbs the cost of future injuries by virtue of its reduced sale consideration.\textsuperscript{75} Under this approach, successor

\textsuperscript{74} The acquirer’s behavior here resembles its approach in the merger situation, where it will also have to bear the target’s future liabilities. \textit{See} discussion supra p. 19. As a practical matter, the situations may be distinguishable insofar as the uncertainty surrounding applicability of the rule of successor liability may make it more difficult for an acquirer to plan appropriately. Widespread adoption of liberal successor liability rules, however, would solve that problem.

\textsuperscript{75} “The point of successor liability is not to impose liability on the successor but to use the successor as a tool to impose liability—through bargaining over the acquisition price—on the target company [the predecessor].” GILSON & BLACK, supra note 26, at 1534. \textit{See also} Green, \textit{Statutory Reform}, supra note 44:

[Successor liability] furthers the goals of compensation, deterrence, risk spreading, and moral retribution that form the foundation of modern products liability law. . . . [O]nce liberal successor liability laws are adopted and become known, successors will inevitably insist on creating some mechanism to ensure that they avoid the predecessor’s future products liability. Potential successors will either discount the purchase price to reflect the future liability, demand that the predecessor acquire insurance or provide some other mechanism to ensure that the predecessor bears the costs of future claims, or, if no acceptable mechanism can be fashioned, withdraw from the proposed acquisition. \textit{Id.} at 40 (citations omitted).

As the Coase Theorem instructs, the efficient outcome occurs regardless of which of the acquirer or the target is initially saddled with the liability, provided that transaction costs are low. The parties will allocate the burden efficiently through their bargaining. \textit{See} Kraakman, supra note 23, at 876 (noting that risk-shifting strategy with flexible approach to initial placement of liability is justifiable only if costs of risk reallocation are low).

Depending on the product, there may be good reason to believe that incremental barriers to bargaining will generally be low. Successor liability is only of concern if the
liability imposes costs on the acquirer not simply to assure payment to sympathetic victims, or to cause the acquirer to spread losses among its consumers, but indirectly to place the costs of accidents where they belong—with the manufacturer.

This cost internalization approach is consistent with the goals of products liability law. Placing the costs on the manufacturer serves to compensate the victim—albeit indirectly—from the party that caused the harm and benefited from its sale. It also furthers the deterrence purpose of tort law. It forces the manufacturer to account for the costs of injuries when making its pricing and product safety decisions. The manufacturer is the party best situated to perform this cost calculus, and with successor liability in place, the manufacturer bears those costs whether it sells the business or not.

acquirer intends to continue the same business or make the same product. Moreover, the typical enterprise has going concern value because of an established name and products. Therefore, products will ordinarily have track records. One would expect the acquirer to investigate product histories as part of its routine due diligence investigation, even absent successor liability, since the acquirer will bear the costs of injuries caused by the very same products of its own future manufacture. See Schwartz, supra note 10: “Imposing successor liability... should not disrupt the orderly operation of capital markets because the successor is in a good position to learn both the rate at which accidents happen and its predecessor’s sales history, and thus be able to calculate the relevant exposures.” Id. at 716. But see Green, Statutory Reform, supra note 44, at 47 (describing complexity of valuing successor liability).

We may also be optimistic about advances in predictive tools, such that accuracy will improve while costs decline. See infra note 300 and accompanying text.

76 See supra note 71.

77 The goal of products liability policy is to insure that the manufacturer takes into account—internalizes—the costs of injuries caused by the product in making decisions about product safety. From this perspective, the function of successor liability is straightforward. Imposing liability on any future purchaser of the manufacturer’s business means that the manufacturer must take the cost of the future products liability claims into account currently because it will always bear them. If it continues to operate the business, it will bear the costs directly through products liability litigation; if it sells the business, it will bear the costs indirectly through a reduction in the price a
Absent successor liability, the manufacturer’s price and cost calculus would be skewed. With the opportunity to duck the costs of future injuries, it would be free to underinvest in safety and underprice its product. That is, the price would fail to reflect all the costs associated with the product. Consumers would consume more of the product than is socially optimal, and the manufacturer would likewise overproduce. The resulting allocation of resources would be inefficient. In the extreme case, a manufacturer would be willing to operate so as to maximize short-term profits, without regard to the costs of future tort liabilities. Its liability-free dissolution option provides a way to cash out the business for the benefit of shareholders without having to account for future injury costs.

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Although the manufacturer may be the best user of its assets, the differing liability rules for it and any acquirer would create a perverse incentive to sell. See Roe, Successor Liability, supra note 36, at 1565.

Some scholars express doubt as to whether the availability of the sale-and-dissolution strategy would affect managers’ production plans. See Green, Statutory Reform, supra note 44, at 36 (“[I]t seems unlikely that many corporations will reduce their investment in safety because they believe that a future corporate transfer will enable them ultimately to externalize products liability costs.”); Merritt B. Fox, Corporate Successors under Strict Liability: A
From the perspective of endgame loss distribution, placing the costs of injuries with the manufacturer serves an additional important goal. It vindicates the priority of future tort victims over the manufacturer’s shareholders. Future tort victims, as creditors of the manufacturer, ought to enjoy payment priority over shareholders. Shareholders are not entitled to any “surplus” at dissolution until creditors are paid in full.\(^\text{80}\) The successor liability discount reduces distributions to shareholders, in effect taking from them for the benefit of future claimants. In this way, successor liability enables future claimants to be paid “ahead of” shareholders.\(^\text{81}\) It protects future claimants from the manufacturer’s shareholders, who would otherwise enjoy inflated distributions at dissolution.

Unlike other proffered justifications for successor liability, the cost internalization rationale explains why the acquirer is the proper party against

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\(^\text{General Economic Theory and the Case of CERCLA, 26 Wake Forest L. Rev. 183, 205-06 (1991) [hereinafter Fox, Economic Theory] (arguing that under a behavioral model of the firm, (i) management will systematically underestimate the risk of future liability in spite of an ex ante rule of strict liability, (ii) management will not be aware of the loss externalization strategy of a sale of assets followed by dissolution, and therefore (iii) whether or not successor liability exists will be irrelevant to management’s production decisions). Moreover, one must generally proceed with caution when ascribing claims of social efficiency to the law of torts. See George Eads & Peter Reuter, Designing Safer Products: Corporate Responses to Product Liability Law and Regulation viii (1983) (concluding that tort law produces only “extremely vague signal” in encouraging firms to take optimal care); John A. Silicano, Corporate Behavior and the Social Efficiency of Tort Law, 85 Mich. L. Rev. 1820, 1822 (1987) (questioning social efficiency model of tort law).}

However, whether or not managers would pursue the most sinister of liability avoidance strategies available, its availability may still be cause for concern.


\(^\text{81}\) By contrast, while the Ray court extolled the virtues of the acquirer as a surrogate loss spreading agent in the manufacturer’s stead, it also found unobjectionable the distribution received by the manufacturer’s shareholders upon its dissolution, as the distribution was authorized by statute. Ray, 560 P.2d at 9.
whom to assess the manufacturer’s future tort liabilities. It explains the
acquirer’s unique position, such that liability imposed on it assures the proper
cost internalization by the manufacturer and the proper distribution upon
dissolution.82

2. Implications for Distress Situations

Adoption of a cost internalization approach does not, of course, end
the discussion. Instead, it suggests a different focus. The proper measure of the
rule of successor liability should concern its effectiveness as a device to force
internalization of the manufacturer’s costs.83 This approach also informs
analysis concerning the scope and limits of the doctrine’s application. For
present purposes, we consider the case where the manufacturer is insolvent at the
time of sale. In that situation, the cost internalization rationale becomes
problematic. Prospects for tort deterrence become dubious, and victim
compensation becomes a more equivocal goal. The current rule may be
overinclusive.84

82 This analysis also answers the objection that successor liability imposes liability without
causation. See, e.g., Polius v. Clark Equip. Co., 802 F.2d 75 (3d Cir. 1986) (finding that need
to compensate tort victims cannot justify this extreme remedy); Woody v. Combustion Eng’g,
Inc., 463 F. Supp. 817, 821 (E.D. Tenn. 1978) (rejecting product line exception). This objection
to placing initial liability on “innocent” parties as part of a risk-shifting strategy should be
rejected, given “a legal world that permits pervasive contractual risk shifting.” Kraakman,
supra note 23, at 875.

83 See, e.g., Green, Statutory Reform, supra note 44, at 21 (concluding that “only one valid
reason exists for holding successors liable: a successor can serve as a conduit to place the
financial burden of future product liability claims on the predecessor by discounting the price
the successor is willing to pay for the predecessor by the predecessor’s projected future
products liability.”); Gilson & Black, supra note 26, at 1532-38 (discussing internalization
approach and possible objections thereto).

84 Remote risks may present another situation where the current rule is overinclusive. There
Theorists recognize that corporate limited liability blunts tort law incentives to take care. Because limited liability enables corporations to externalize risk, they may be underdeterred from risk-generating activities ex ante.\textsuperscript{85} A firm will be deterred by the threat of liability to the extent of the firm’s worth, but will be indifferent to the threat of additional liability.\textsuperscript{86} The prospect of successor liability in the insolvency situation is simply a threat of excess may be products for which the harmful effects are unknown at the time the business is sold. The product history will therefore not be helpful for estimating future liabilities. In that case, arguably imposition of successor liability is unfair and unproductive, since the costs of future injuries could not possibly have been accounted for in the bargaining over the purchase price, and therefore no cost internalization could have been effected. See Schwartz, supra note 10 (arguing that for knowable tort risks, reforms to current corporate and bankruptcy law could force firms to better internalize costs, but that imposition of liability for remote risk is unfair and inefficient, and no reform will help). Cf. Fox, Economic Theory, supra note 79, at 218 (asserting that informational disparities as between acquirers and sellers with respect to potential environmental liabilities suggest that successor liability in that context may be less appropriate than in the product liability context).

However, this failure of cost internalization may not necessarily be a problem of successor liability in the first instance, but a problem with strict liability generally. The predecessor would have been liable for these remote injuries had it maintained the business, even though by definition an “unknowable” harm cannot be deterred by strict liability or insured against. See Schwartz, supra note 10, at 694 (defining as “unknowable” any danger in excess of what a cost-effective amount of safety research would have disclosed). Because the predecessor would have been liable, the successor is made to pay, even though the deterrence aim of strict liability would not be promoted in either case. On the other hand, one can imagine the practical problems for courts attempting to discern whether a particular harm was knowable or not. Such a finely tuned rule of strict liability might not be cost-effective. See Gilson & Black, supra note 26, at 1538.

\textsuperscript{85} In particular, firms may spend too little on accident avoidance, and they may engage in socially excessive levels of risky activity. See Steven Shavell, The Judgment Proof Problem, 6 INT’L. REV. L. & ECON. 45 (1986) (finding that judgment-proof parties have insufficient incentives to take care and may engage in excessive amounts of risky activity); Henry Hansmann & Reinier Kraakman, Toward Unlimited Shareholder Liability for Corporate Torts, 100 YALE L.J. 1879, 1882 (1991) (noting that limited liability creates incentive for corporation to spend less than efficient amount on accident avoidance and to overinvest in hazardous industries); Kyle D. Logue, Solving the Judgment-Proof Problem, 72 TEX. L. REV. 1375 (1994) (“The deterrence goal [of tort law] is undermined because . . . judgment-proof tortfeasors will not fully internalize the costs of the accidents they cause.”).

\textsuperscript{86} For example, a firm with $1 million in assets will have no more incentive to avoid an accident causing $5 million in losses than an accident causing only $1 million in losses, since the cost to the firm is the same in either case. The former is clearly less desirable from society’s point of view but not from the firm’s.
liability. The firm will be indifferent to it ex ante, and it will not deter.\textsuperscript{87}

Successor liability precludes only cost externalization that would otherwise be possible \textit{short of} insolvency. It uses the acquirer to pass the costs of future injuries back to the manufacturer. For the solvent manufacturer, the successor liability discount effectively charges the firm with future tort losses upon its sale and dissolution. The ex ante threat to the firm’s value forces cost internalization and furthers the goal of tort deterrence. But because the threat only matters to the extent of the firm’s worth, successor liability cannot deter beyond that point.

Consider the effect of successor liability if the firm is insolvent when it sells the business. Responding to the successor liability risk, the acquirer will discount its bid, just as it does if the firm is solvent. However, with insolvency, the burden of reduced sale proceeds is borne not by the firm or its shareholders, but by unsecured creditors. It is \textit{their} distributions in dissolution that are reduced. The firm’s shareholders, by contrast, suffer a total loss of their investment in the firm \textit{regardless} of any successor liability discount. Losses in excess of the firm’s value are left with creditors. Future tort losses are borne

\textsuperscript{87}Not only will deterrence fail, but once the firm is insolvent, managers may have incentive to engage in excessively risky investments. Managers with continuing loyalty to shareholders will follow such an investment strategy because the risks are borne by creditors, while shareholders may share in the benefits of a successful high-risk, high-return bet. \textit{See} Michael C. Jensen & William H. Meckling, \textit{Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure}, 3 J. FIN. ECON. 305, 334-37 (1976) (discussing conflict between shareholders and creditors in insolvency context); Jeremy I. Bulow & John B. Shoven, \textit{The Bankruptcy Decision}, 9 BELL J. ECON. 437, 439-40 (1978) (same). Managers may also adopt such an investment approach simply to improve their chances of saving the company, returning to favor and retaining their jobs. \textit{See} Lynn M. LoPucki and William C. Whitford, \textit{Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies}, 141 U. PA. L. REV. 669, 684 (1993).
either by future tort victims—if successor liability does not apply—or by current unsecured creditors—if it does. In that situation, successor liability is irrelevant to tort deterrence. It will not deter because further tort liability cannot deter. And the firm will likewise be indifferent to any ex ante threat of successor liability in the insolvency context.

Because current unsecured creditors bear the future tort losses shifted to the manufacturer via successor liability, victim compensation becomes a more equivocal end. Future claimants stand to recover in full from the acquirer, with current creditors having absorbed the costs of the successor liability discount. Placing the full costs of future tort liability on the manufacturer’s current creditors prefers future claimants over current creditors. In essence, current creditors are made guarantors for full payment of the manufacturer’s future tort liabilities. Such a redistribution of losses is arbitrary.  

Not imposing successor liability, of course, leaves endgame losses with future claimants. So in the insolvency context, a choice between successor liability and no successor liability is effectively a choice between future and current creditors. But under our current system, neither has any claim to priority

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88 See Nat’l Gypsum Co. v. Continental Brands Corp., 895 F. Supp. 328, 334 (D. Mass. 1995) (noting in successor liability context that insolvent corporation’s asset sale that leaves insufficient assets to pay unsecured creditors does not “offend our sense of equity. While creditors may lose out, corporate shareholders are penalized as well, as an insolvency will reduce the value of their stake in the corporation to zero.”). See also Green, Statutory Reform, supra note 44, at 46 (“To the extent that the predecessor’s financial inability is a result of insolvency incurred during continuing operations, the problem is one for bankruptcy law, and liability should not be imposed on the successor.”).
over the other. Because neither distribution of losses is preferable, and because the rule is costly, it should not apply when the predecessor is insolvent at the time of sale.

Under a cost internalization rationale, then, successor liability should not be conceived of as a remedy to compensate future tort victims whenever corporate sale and dissolution would otherwise leave them without a remedy. It should apply only when cost internalization is achievable; that is, when the firm is solvent. From the perspective of endgame loss distribution, successor liability is an appropriate response to attempts to end run around the priority that future tort creditors ought to enjoy over the corporation’s

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89 If current creditors were all voluntary creditors and could be said to have assumed the risk of insolvency, then they would have no cause to complain of bearing losses as a result of internalization of the manufacturer’s future tort liabilities. Also to the extent that voluntary creditors are able to diversify, a case can be made for priority of tort claimants and other involuntary creditors over voluntary creditors. See David W. Leebron, Limited Liability, Tort Victims, and Creditors, 91 COLUM. L. REV. 1565, 1643 (1991). Under such a reform, a cost internalization approach to successor liability might require imposition of successor liability even if the predecessor were insolvent.

However, this approach would only make sense if current creditors were all voluntary creditors able to adjust for default risk. That is unlikely. Some current creditors will also be either involuntary creditors or voluntary creditors who cannot adjust—for example, employees or small trade creditors. See Bechchuk & Fried, supra note 23, at 864 (describing “nonadjusting” creditors). See also LoPucki, The Unsecured Creditor’s Bargain, supra note 23, at 1896 and n.41 (noting prevalence of involuntary debt and speculating that companies in financial distress will have proportionately more of it). As to them, diversification and assumption of risk arguments are problematic. Moreover, a reform reordering priorities among various classes of unsecured creditors, if made, should be made across the board, and not simply in the relatively narrow circumstance of successor products liability.

90 See supra note 62 and accompanying text.

91 As a practical matter, however, it might be difficult for courts to decide after the fact of sale—that is, at the time the successor liability suit is brought—whether liabilities exceeded firm value even without accounting for future claims liability. If shareholders received no consideration in dissolution, it might have been because the acquirer discounted its purchase price to account for successor liability risk. If so, then failure to impose successor liability would result in a windfall to the acquirer at future claimants’ expense.
shareholders. From that perspective, the primary injustice to be addressed is not simply that future tort victims will go uncompensated, but that they will receive no compensation, *while the corporation’s shareholders do.*

**D. Summary**

The sale of a business may enable externalization of future tort liabilities, encouraging socially inefficient operations and leaving endgame losses with future tort victims. The manufacturer’s shareholders and the acquirer share the gains from such externalization. Successor liability attempts to protect future tort victims from that outcome.

A cost internalization rationale explains the acquirer’s role in (i) forcing the manufacturer to account for the costs of future injuries in its operating decisions, and (ii) shifting endgame losses from future claimants to the manufacturer and its shareholders. The acquirer is uniquely situated to perform these roles. Furthermore, under a cost internalization rationale, successor liability should not apply when the manufacturer is insolvent at the time of sale.

The next Part introduces bankruptcy reorganization and the sale of a business in bankruptcy.

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92 Moreover, this characterization is probably true as a positive matter under current law, as well as a normative matter under a cost internalization approach. Going concern sales will ordinarily generate returns for the target’s shareholders. That is, the predecessor will be solvent. The reason is that under state law, the target’s shareholders must approve the corporation’s sale of all its assets. *See, e.g., Model Bus. Corp. Act § 12.02 (1994).* Shareholders may be reluctant to vote in favor of selling out in a situation where they stand to gain nothing. *See* Roe, *Successor Liability,* *supra* note 36, at 1579 n.52. To the extent that bankruptcy reorganization may offer the prospect of better returns to shareholders, they may hold out for that.
III. BANKRUPTCY REORGANIZATION AND BANKRUPTCY SALES

Going concern asset sales happen in bankruptcy as well as outside. As in the nonbankruptcy context, such a sale may implicate future claims and liability avoidance issues. The target in bankruptcy will attempt to sell the business “free and clear” of successor liability, relying on the bankruptcy system to cleanse the assets of any taint of future claims liability.

A. Reorganization and the Common Pool

Bankruptcy is meant to solve a common pool problem among creditors.\(^\text{93}\) It provides a mechanism for collective settlement of the debtor’s multiple obligations in one proceeding, through which losses are distributed among creditors. Individual creditor collection efforts are halted in favor of this collective proceeding that attempts to maximize recoveries for creditors as a group.

The classic common pool problem involves a scarce resource—say, a pond filled with fish—shared among multiple parties. Individual and group interests may diverge as to the use of the shared resource. For each individual with access to the pond, it might serve her individual interest to harvest as many

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\(^{93}\) See Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968) (describing ruin of shared resource from individual pursuit of self-interested ends with respect to shared resource).

fish as she can, as fast as she can. But the group would probably be better off setting limits on each individual’s catch. If the parties could coordinate and enforce limits on their individual harvesting, they could assure that enough fish remained in the pond to repopulate it indefinitely. The group could assure itself a perpetual source of fish.

However, the parties might be unable to coordinate their decision making. Or they might be unable to enforce any collective decision. If the group is unable to limit each individual’s harvest, then it makes sense for each individual to pursue her own self-interest. This leads, unfortunately, to the destruction of the pond as a resource.94

In bankruptcy, the debtor’s assets are the common pool. Creditors are the parties with access to the common pool once the debtor is in financial distress. Absent imposition of bankruptcy’s collective proceeding, under state law collection rules, the debtor’s assets are divvied on a first-come first-served basis. Creditors race against each other to seize assets in satisfaction of their respective debts.95 While the speedy creditor may do well, creditors as a group are worse off than if they could coordinate their collection efforts, which is usually impossible under state law.96 The race to the debtor’s assets results in

94 See Thomas H. Jackson, The Logic and Limits of Bankruptcy Law 10-13 (1986) (describing bankruptcy as a device to solve common pool problems among creditors) [hereinafter Jackson, Logic and Limits].


piecemeal dismemberment of the debtor’s business, forsaking going concern value that could have been applied to satisfy creditor claims.97

Chapter 11 reorganization coordinates collection activity in order to benefit creditors as a group. It attempts to maximize creditor recoveries by preserving the going concern value of the business. The debtor’s management remains in place,98 authorized to continue ordinary course operations,99 while creditors and the debtor negotiate a plan of reorganization.100 Creditors must approve any plan,101 but for the duration of the case, the automatic stay precludes individual creditor collection efforts against the estate.102 The confirmed plan serves as the blueprint for the reorganized debtor’s capital structure, specifying what each creditor receives in consideration for its claim. Typical plan consideration will be either a new scaled down claim against the reorganized debtor, cash, or some combination. Creditors must await confirmation of the plan in order to receive their plan consideration, which is their exclusive

97 Even if there is no going concern value, such that piecemeal liquidation is the best disposition of the assets, an orderly liquidation will likely garner more proceeds overall than an uncoordinated fire sale.


99 The debtor is authorized to use, sell or lease assets of the estate in the ordinary course of business (except for cash collateral), see id., § 363(c), and may incur unsecured debt in the ordinary course of business as an administrative expense. See id., § 364(a).


102 See id., § 362. The bankruptcy estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” Id. § 541(a)(1).
recovery from the estate. Upon confirmation, all preconfirmation debts are discharged, and creditors are enjoined from pursuing the reorganized debtor on any preconfirmation debt.

Two fundamental norms underlie this system of loss distribution: absolute priority and equal treatment. Under the absolute priority rule, a class of unsecured claims or interests is not entitled to any bankruptcy distribution unless and until each senior class either consents or is paid in full. The rule of equal treatment requires that similarly situated creditors receive equality of treatment.

**B. Future Claims and the Common Pool**

Future claims present a unique challenge for bankruptcy’s solution to the common pool problem. Given that the identities of future claimants and

\[^{103}\text{See id. } \S 1141(d).\]

\[^{104}\text{See id., } \S 524(a).\]

\[^{105}\text{See id., } \S 1129(b)(2)(B). \text{ See also Tung, supra note 100, at 1692-1693 (explaining rule of absolute priority).}\]

\[^{106}\text{See Begier v. Internal Revenue Service, 496 U.S. 53, 58 (1990) (“Equality of distribution among creditors is a central policy of the Bankruptcy Code. According to that policy, creditors of equal priority should receive pro rata shares of the debtor’s property.”).}\]

\[^{107}\text{Some have questioned the applicability of the common pool model to bankruptcy. See Randal C. Picker, Security Interests, Misbehavior, and Common Pools, 59 U. CHI. L. REV. 645 (1992). Professor Picker notes that the classic common pool problem involves an overlapping distribution of rights among strangers, but that for the most part the debtor and its creditors are not strangers. Their prebankruptcy relationships enable contracting that can minimize the common pool problem. Therefore, according to Professor Picker, bankruptcy is more accurately modeled as a small decision making problem embedded in a larger one—that is, an embedded game—and not as a simple free-standing common pool problem. See id. at 647-49.}\]

Future claimants, of course, are not voluntary creditors. They and other involuntary creditors have no real opportunity to negotiate their way around common pool problems. That they are strangers to each other and to contract creditors suggests that the common pool model continues to be useful.
the amounts and timing of their respective claims may be difficult to ascertain at the time of bankruptcy, coordinating bankruptcy’s collective settlement becomes quite complicated. As discussed below, incorporating future claims into the settlement may be expensive in transaction cost terms.\textsuperscript{108} On the other hand, leaving them out creates a holdout problem that bankruptcy is specifically designed to cure.\textsuperscript{109} A collective settlement that fails to include future claimants may be ineffective to preserve the value in the common pool. A current claimant would naturally be reluctant to limit her ability to grab assets if she knew that later arriving claimants would not be so restricted. And even if she could be restrained from self-help indefinitely, the specter of unresolved future asset grabbers might destroy going concern value today.

\textbf{C. The Bankruptcy Sale}

Instead of reorganizing internally, the parties in interest may decide to sell the assets of the estate as a going concern. While we generally conceive of the former as “reorganization” and the latter as “liquidation,” the two alternatives are not so dissimilar. In both cases, going concern value is preserved while a new capital structure is created for the business. As Deans Baird and Jackson have explained, one can conceptualize reorganization as a hypothetical sale of the going concern to prepetition creditors, who “purchase” their postbankruptcy participations in the business with their prepetition

\textsuperscript{108} See infra Part IV.C.

\textsuperscript{109} See Jackson, Logic and Limits, supra note 94, at 13 (noting collective and compulsory nature of bankruptcy proceeding); Keating, supra note 96.
claims.\textsuperscript{110}

The primary difference between internal reorganization and the going concern sale is simply the identity of the investors in the business at the end of the day. With internal reorganization, prepetition creditors constitute the reorganized debtor’s postpetition investors. With the going concern sale, the common pool of estate assets is exchanged for cash (or securities or whatever other consideration is paid for the business). Creditors relinquish their prepetition claims in return for shares of this new pool, and the third party purchaser owns the business.\textsuperscript{111} Creditors’ claims are paid out of the sale consideration in absolute priority order, respecting as well the rule of equal treatment.\textsuperscript{112} This going concern sale may therefore be conceived of as an “external reorganization.”

As is the case outside of bankruptcy, proceeds of the bankruptcy sale, and therefore creditor recoveries, will be maximized if the going concern is sold free of existing liabilities. The typical acquirer will prefer to buy the

\textsuperscript{110} See Baird, The Uneasy Case, supra, note 5; Jackson, Logic and Limits, supra note 93, at 210-211 (describing reorganization as a form of asset sale). See also Robert C. Clark, The Interdisciplinary Study of Legal Evolution, 90 Yale L.J. 1238, 1250-54 (1981) (describing evolution of modern reorganization statute from collective liquidation procedures and equity receiverships).

\textsuperscript{111} Hybrid outcomes are also not uncommon. A capital structure for a reorganizing entity may include new investors as well as prepetition creditors. An outside acquirer could basically buy the business via reorganization. Instead of an outright purchase of the assets, the acquirer might make a capital contribution to the reorganizing debtor in exchange for some or all of the reorganizing debtor’s shares of common stock issued under the plan.

\textsuperscript{112} This sale and distribution typically occurs as part of a liquidating plan in Chapter 11. Distribution of the proceeds occurs upon confirmation of the plan. See infra note 241 and accompanying text.
business “clean,” and the bankruptcy court will approve the sale “free and clear” of prebankruptcy liabilities. However, if some of those prebankruptcy liabilities are future claims, then the external reorganization scenario may implicate successor liability concerns. As with asset sales outside of bankruptcy, future claims are ordinarily ignored in external reorganization. How they should be treated, and whether successor liability may survive a bankruptcy sale, are unsettled questions that are addressed, respectively, in the next two Parts.

IV. FUTURE CLAIMS IN REORGANIZATION

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113 See infra Part V.A.
Proper treatment of future claims is an unsettled question in both internal and external reorganization. In mass tort reorganizations, where the sheer magnitude of future claims liability threatens the survival of a large company, future claims have been included in the bankruptcy proceedings.\footnote{See infra Part IV.C.1.} However, outside of that context, future claims are generally ignored.\footnote{See e.g., Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714 (1st Cir. 1994) (bankruptcy sale of firearms manufacturer that made no provision for future claims); Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.), 184 B.R. 910 (Bankr. W.D. Tx. 1995) (bankruptcy sale of aircraft manufacturer with no provision for future claims in liquidating plan). See also Jeffrey Davis, Cramming Down Future Claims in Bankruptcy: Fairness, Bankruptcy Policy, Due Process, and the Lessons of the Piper Reorganization, 70 AM. BANKR. L. J. 329, 337 (1996) (noting that prior to appearance of future claimants to assert their rights, “the threat of future claimants had never seemed significant to warrant much attention by the reorganizing parties.”). But see Conway v. White Trucks, 885 F.2d 90, 91 (3d Cir. 1989) (describing provision for future claims in reorganization plan).} Structuring bankruptcy mechanisms to address the rights of future claimants may be expensive relative to the amounts at stake.\footnote{For example, appointment of a special representative may be necessary in order to accord due process to future claimants. See infra Part IV.C.1.} And even if future claimants are legally entitled to be included as creditors in bankruptcy—an issue that is unclear under current law—at the time of bankruptcy, they are largely unaware of their rights and not in a position to assert them.

Bankruptcy theorists agree—without focusing specifically on external reorganization—that future claims may be handled in bankruptcy.\footnote{See, e.g., Baird, The Uneasy Case, supra note 5, at 145-46; Thomas H. Jackson, Translating Assets and Liabilities to the Bankruptcy Forum, 14 J. LEGAL STUD. 73, 96 (1985) [hereinafter Jackson, Translating Assets and Liabilities]; Carlson, supra note 31, at 145; Heidt, Changing Paradigm, supra note 11; Keating, supra note 96; Ralph R. Mabey & Peter A. Zisser, Improving Treatment of Future Claims: The Unfinished Business Left by the Manville Amendments, 69 AM. BANKR. L. J. 487, 488 (1995) (asserting that bankruptcy court is the “best forum” for mass tort future claims cases).}
However, they disagree as to whether future claims must always be included, or whether their inclusion should depend on the discretion of plan proponents—typically, the debtors. Under this latter “flexible approach,” future claims excluded from the process would simply retain their nonbankruptcy rights.

A flexible approach may be unobjectionable in some bankruptcy contexts. However, I argue that in external reorganization, a flexible approach merely enables exploitation of future claimants. If their inclusion is optional, external reorganization becomes one more device by which an acquirer and residual claimants—here, current creditors—conspire to leave losses with future claimants.

My prescription for proper treatment of future claims in external reorganization has two components. First, future claims should always be included in the bankruptcy proceeding and receive equal treatment with the debtor’s other creditors. Second, as an incident to inclusion of future claims,


118 See infra note 127-129 and accompanying text.

119 See Davis, supra note 115, at 361; NBC FINAL REPORT, supra note 117, at 282; NBRC REPORT, supra note 117. For a description of these three reform proposals adopting the flexible approach, see infra note 131.

120 This point is not made explicit in the NBC FINAL REPORT. However, the report does note the unfairness of insulating the reorganized concern from future claims without providing for their payment. NBC FINAL REPORT, supra note 117, at 283. See also Davis, supra note 115, at 363 (stating that future claims ignored in bankruptcy must be “left unaffected”).
successor liability should be enjoined. This Part discusses the first aspect of my prescription, as part of the larger question of treatment of future claims in reorganization generally. I leave the discussion of successor liability to the next Part.

Including future claims in reorganization comports with fundamental bankruptcy policies. However, in many cases, addressing future claims may be expensive in transaction cost terms, relative to the stakes involved. A flexible approach avoids having to incur these costs in every case.

In this Part, I begin by explaining the conceptual basis for comprehensive inclusion of future claims. I then introduce the flexible approach. Next, I contrast the mass tort bankruptcies with the ordinary cases, illustrating the transaction costs of addressing future claims and courts’ struggle to align conceptual clarity with practical cost consequences. Finally, I compare internal and external reorganization. I suggest that a flexible approach might be plausible in internal reorganization. However, in external reorganization, such an approach fails to respect future claimants’ rights as creditors, but merely enables subversion of such rights.

A. Including Future Claims

It is a relatively uncontroversial proposition among bankruptcy scholars that the bankruptcy system, if called upon, should be capable of addressing future claims.\textsuperscript{121} Dealing with future claims is consistent with

\textsuperscript{121} Whether the bankruptcy system is the ideal or best place to handle future claims is subject to some debate. Compare Coffee, Class Wars, \textit{supra} note 2, at 1457 (finding bankruptcy
fundamental bankruptcy goals.

Bankruptcy provides a clear demarcation between the debtor’s past and future. It marks a day of reckoning among the debtor and all its obligees—including future claimants, as to whom the debtor’s liability-creating conduct has already occurred and cannot be unwound. Including future claims allows the debtor to make a clean break with its past, while allowing victims of the debtor’s past mistakes to share in the value available at the time of bankruptcy. Judge Easterbrook describes this concept quite aptly:

Bankruptcy separates the past and future of an enterprise, satisfying claims attributable to yesterday’s activities out of existing assets and thereby enabling business operations that have positive value to carry on, unburdened by the sunk costs of blunders that are beyond recall. By letting bygones be bygones, from the firm’s perspective, while assuring some compensation to those who learn in the future that these bygones caused them injury, a plan of reorganization . . . promotes both productivity and compensation. Failing to satisfy, out of assets available at the time of the petition, the claims of persons whose injury becomes manifest after the filing of the petition, would simultaneously provide (other) creditors with excessively large shares of the estate, and create a drag on ongoing operations that could cause the dissolution of business ventures with positive cash flow (and thus potentially substantial social and private value). 122

Inability to include future claims in bankruptcy’s collective settlement would tend to frustrate bankruptcy goals. Having to answer for past mistakes outside of the collective proceeding would cause a diversion of the

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122 In re UNR Ind. Inc., 20 F.3d 766, 771 (7th Cir. 1994) (Easterbrook, J.) (citations omitted).
reorganized debtor’s cash and other resources, and might ultimately imperil
survival of the business. Assuming the business is worth more alive than dead,
saving the going concern also maximizes recoveries for creditors, including
future claimants. Even if future claims liability were not significant enough to
threaten the viability of the post-reorganization going concern, the continuing
specter of liability might hamper operations. This would diminish the value of
the reorganized debtor, and creditors’ bankruptcy distributions would be
diminished accordingly.

Failure to include future claims would also result in differential
treatment among the debtor’s various obligees. In particular, it would mean
differing treatment as between current and future tort victims, and among future
tort victims inter se. All are injured by the identical prebankruptcy conduct of

123 A collective process that commences well before the damages or injuries develop might
be the only opportunity for future claimants to receive any compensation, both because
otherwise early claimants may take all the assets of the company or the company’s
extraordinary potential liability will dry up access to all capital needed for ongoing
business operations.

NBRC REPORT, supra note 117, at 315. See also Keating, supra note 96, at 1099 (noting that
bankruptcy’s solution to collective action problem preserves going concern value of firm whose
survival threatened by future claims); Roe, Mass Tort, supra note 2; Heidt, Changing
Paradigm, supra note 11, at 1084 (arguing that failing to free debtor from consequences of
prebankruptcy acts would jeopardize reorganization); Baird, The Uneasy Case, supra note 5, at
145-46 (when future tort victims’ claims exceed firm’s net worth, sale of business to third party
must be free of future tort liability in order to preserve going concern and maximize sale
proceeds, with tort victims sharing in sale proceeds). See infra Part IV.C.1 for a discussion of
the problem of gradual operational collapse from the specter of future claims liability.

124 “Fundamental principles of justice require that a person who develops asbestosis 40 years
after exposure should have the same entitlement to compensation as a person who got
asbestosis 25 years earlier from the same exposure.” NBRC REPORT, supra note 117, at 318.
See also Smith, supra note 8, at 378-82 (arguing that risk averse tort victims would choose rule
of equal treatment among themselves in Rawlsian hypothetical bargain); Heidt, Changing
Paradigm, supra note 11, at 1084 (describing unequal treatment if future claims not included).
But see Roe at 855 (denying applicability of hypothetical bargain rationale to involuntary tort
claimants and asserting that temporal equality in compensation cannot be unambiguously
the debtor but would receive differing treatment based on the serendipity of the timing of their respective injuries and the vagaries of state law.

The current tort victim receives her ratable share of the common pool along with other creditors. The excluded future tort victim must pursue her nonbankruptcy rights. If the debtor reorganizes internally, then the future tort victim may recover in full.125 If the debtor instead reorganizes externally—sells the business—the future claimant is placed in an all-or-nothing position. The debtor will have distributed its assets and disappeared by the time of the future claimant’s injury. If she is lucky, successor liability is available in her state, and she may recover in full from the acquirer. If unlucky, she receives nothing.126

B. Mandatory Inclusion versus Flexibility

A rule of mandatory inclusion, then, rests upon a solid conceptual foundation. Because it accords with basic bankruptcy norms, its advocates claim derived from fairness principles).

I argue infra that in the external reorganization context, future claimants should receive equal treatment not only with each other and current tort claimants, but with current claimants generally. See infra Part IV.D.5.

125 See infra note 185 and accompanying text.

126 In general, exclusion from bankruptcy’s common pool is undesirable from the future claimant’s perspective. If excluded, a future claimant will recover when (a) a going concern is internally reorganized or (b) the going concern is sold and the future claimant enjoys successor liability rights against the acquirer. As a practical matter, however, most going concerns will not survive bankruptcy but will eventually be liquidated piecemeal, which does not produce any entity to sue. And as to those going concerns sold through external reorganization, successor products liability is hit-or-miss, mostly miss. So for the most part, exclusion of future claimants from bankruptcy leaves them with no recovery whatsoever. See generally DOUGLAS G. B AIRD, THE ELEMENTS OF BANKRUPTCY 90-91 (rev. ed. 1993) (describing future claimant’s different prospects depending on whether debtor is liquidating or reorganizing); Jackson, Translating Assets and Liabilities, supra note 117, at 94 (unascertained tort claimants may be better off without successor liability in bankruptcy if as consequence of its application, such tort claimants would be left out of the process, while other creditors controlling asset disposition push for piecemeal liquidation, leaving “unascertained” claimants with nothing).
it as the only defensible approach. To be sure, theorists emphasize different aspects of bankruptcy’s multifarious goals in their analyses. Some emphasize the fundamental separation of the debtor’s past from its future. Others focus as well on the related purpose of debtor rehabilitation. They reason—either implicitly or explicitly—that because future claims must be included in some cases in order to assure a successful reorganization, then for consistency’s sake, they should count as prebankruptcy “claims” to be dealt with in all cases. Still others emphasize an equal treatment rationale.

For the most part, however, they fail to consider the transaction

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127 See Jackson, *Translating Assets and Liabilities*, supra note 117, at 82 (stating that future claims based on debtor’s past acts that are cognizable under state law and have some value at time of bankruptcy should be treated as prebankruptcy claims):

> If the debtor were to cease doing business on the filing of the petition, it would not influence the likelihood that [asbestos] claimants would eventually exhibit the signs of an asbestos-related disease attributable to the debtor’s product. The company’s future survival is irrelevant to whether or not the disease or injury manifests itself.

*Id.*

128 See *Baird, The Uneasy Case*, supra note 5, at 145-46 (using going concern sale example to show that survival of business may depend on treating future claims in bankruptcy); *Heidt, Changing Paradigm*, supra note 11, at 1084 (asserting that comprehensive inclusion is required to assure successful reorganization); *Keating, supra* note 96, at 1098 (arguing that only conduct test—which holds that a bankruptcy claim exists if the debtor’s prebankruptcy conduct will ultimately give rise to the claim—works in solving state law collective action problem, and that inclusion should not depend on the projected magnitude of future claims liability); *Roe, Mass Tort*, supra note 2 (arguing for inclusion of future claims in mass tort context but refraining from prescribing any distributional norm).

129 See *supra* note 124 and accompanying text. While Professor Smith focuses on the mass tort context, his equal treatment analysis implies that future claims should be included in other bankruptcy contexts as well and receive equal treatment with current tort victims. Ironically, the NBRC proposal explicitly adopts an equal treatment rationale as a basis for including future claims, *see NBRC REPORT, supra* note 117 at 318 (equal treatment with current tort claims), 321 (equal treatment with current claims in liquidation), yet at the same time limits its prescription to the mass liability situation. *Id.* at 322. For further discussion of applicability of the equal treatment norm, *see infra* Part IV.D.5.
costs that such a rule may generate, or the effect of such costs on reorganization. Its implementation may be problematic in many cases.

The flexible approach is more pragmatic. It enables consideration of such costs. As Professor Davis points out, mandatory inclusion “would place an undue and frequently unworkable burden on all

130 One exception is Professor Keating, who has identified the due process and estimation problems with an approach requiring comprehensive inclusion of future claims. He suggests that the insurance market may be available to ameliorate some of these problems. Keating at 1100-02.

131 Three separate reform proposals adopt this general approach. The National Bankruptcy Conference proposes that future claims be cognizable in bankruptcy, but that the Chapter 11 plan proponent—typically the debtor—be entitled to decide whether to include future claims. See NBC Final Report, supra note 117, at 283-84.

The National Bankruptcy Review Commission proposes to include future claims in the mass liability context, but specifically declines to address future claims outside that context. Even in a mass liability situation, future claims are not assured of being included. They qualify for inclusion as “mass future claims” if “the debtor has been subject to numerous demands for payment for injuries or damages” arising from liability-creating prepetition conduct, and “is likely to be subject to substantial future demands for payment on similar grounds.” NBRC Report, supra note 117, at 322. However, whether those conditions obtain will presumably be decided by plan proponents. Moreover, appointment of a future claims representative is required only if (a) the plan attempts to deal with mass future claims or (b) a party in interest petitions for such an appointment. See id. at 329. This arrangement effectively leaves to other parties the decision whether unrepresented future claimants should be included. It probably amounts to a flexible approach in practice.

It might be theoretically possible for future claimants to participate or petition for representation. However, no future claimant would typically have enough financial incentive to do so. See supra note 10 and accompanying text. It might be possible that bounty-hunting lawyers would serve as watchdogs for future claimants’ interests. See Davis, supra note 115, at 379 (speculating that class action lawyers will protect future claimants). See generally John C. Coffee, Jr., Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions, 86 Colum. L. Rev. 669 (1986) (discussing economic incentives of and constraints on “bounty hunter” plaintiffs’ attorneys). That practice, however, has yet to develop in the future claims context, and courts’ reaction to such a practice is difficult to predict.

Professor Davis’ proposal provides even more flexibility than the preceding two. Not only may future claims be ignored in reorganization, but even after the decision is made to include them and a future claims representative appointed, his proposal allows future claims to be cut out of any bankruptcy distribution as a form of cramdown. Davis, supra note 115, at 363.
Proposals for a flexible approach are premised on the idea that reorganization should afford some mechanism by which final disposition of future claims may be accomplished, and that resort to such a mechanism requires appropriate treatment for future claims, but that resort to the mechanism should be at the option of the plan proponent. Whether to include future claims would presumably be part of any plan negotiation, with the debtor and current creditors deciding whether the transaction costs were “worth it.” And presumably they would decide to include future claims only if that were necessary to save the going concern.

It should not surprise that the National Bankruptcy Conference and the National Bankruptcy Review Commission—whose numbers include not only academics but also prominent judges and practitioners, who must deal with the

\[\text{\textsuperscript{132}}\text{Davis, supra note 115, at 366.}\]

[U]nless a fund of significant size is created, there is a danger it will eat itself up in administrative costs before paying out to future claims. . . . Furthermore, the cost of appointing a representative and paying that representative to investigate and participate in the valuation of future claims and the design of a fund will be significant. To impose these costs on every reorganization would make little sense, especially because future claims, while always a possibility, are rarely a significant problem for most businesses.

\[\text{Id. See also NBRC REPORT, supra note 117, at 332 (noting question of cost-efficiency in requiring appointment of future claims representative in every case disposing of mass future claims).}\]

\[\text{\textsuperscript{133}}\text{What counts as “appropriate” varies depending on the proposal. All three require appointment of a representative for future claims. See NBC FINAL REPORT, supra note 117, at 284. Only the NBRC proposal embraces equal treatment for future claims with current claims. See supra note 129127. As noted earlier, while Professor Davis’ proposal requires appointment of a future claims representative, if it were decided later in the case that future claims should be ignored after all, his proposal would allow their exclusion. See discussion supra note 131.}\]

\[\text{\textsuperscript{134}}\text{See Davis, supra note 115, at 361 (“Businesses differ. Sometimes the reorganization will best be facilitated by bringing future claims into the plan, and sometimes the reverse will be true.”). However, see infra Part IV.D for a discussion of less benign motivations in the}\]
real world consequences of future claims in bankruptcy—would favor flexibility in handling future claims.\textsuperscript{135} It should also not surprise that the courts have been less than uniform in their treatment of and analyses concerning future claims.\textsuperscript{136}

\textbf{C. Transaction Costs and Conceptual Clarity}

The question of treating future claims in bankruptcy first became an issue with the mass tort bankruptcies.\textsuperscript{137} These cases provided the original context in which lawyers, courts and theorists worked out the theory and practice relating to future claims in bankruptcy. From these cases has emerged a now “traditional” model for addressing future claims. This model solution is not costless, however. A large case can support it. But courts in other cases, with only this ready model from which to work, have struggled attempting to reconcile conceptual clarity with scarcity of resources. This section sketches the courts’ struggle with the different types of cases.

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\textsuperscript{135} Indeed, the need for flexibility may have been so self-evident within the National Bankruptcy Conference that its report describes this aspect of its proposal in two sentences, with no express justification or even commentary. \textit{See NBC Final Report, supra note 117}, at 284. Judge Mabey’s article outlining the NBC proposal likewise makes no mention of the debtor’s discretion built into the proposal. \textit{See} Mabey & Zisser, \textit{supra} note 117, at 503.

\textsuperscript{136} \textit{See infra} Part IV.C.2.

\textsuperscript{137} \textit{See}, e.g., Smith, \textit{supra} note 8; Roe, \textit{Mass Tort, supra} note 2; Harvey J. Kesner, \textit{Future Asbestos Related Litigants as Holders of Statutory Claims Under Chapter 11 of the Bankruptcy Code and Their Place in the Johns-Manville Reorganization}, 62 Am. Bankr. L. J. 69 (First Installment) and 159 (Second Installment) (1988); NBRC Report, \textit{supra} note 117, at 322 (explaining report’s exclusive focus on mass liability cases because they are “the most pressing and most complex cases, where the claims . . . are so massive that they warrant special procedures and protections”). \textit{See also} Heidt, \textit{Changing Paradigm, supra} note 11, at 1061 (describing “extraordinary liabilities” of mass tort and environmental obligations).
1. The “Traditional” Approach in the Mass Tort Context

A mass tort case involves a large company that has mass manufactured a product that later proves to be harmful. The company resorts to bankruptcy in order to deal with the ensuing “enterprise-threatening massive liabilities.” Such a company finds itself in dire financial straits, not necessarily because it is short of cash and has trouble meeting current expenses. Instead, its primary concern is future products liability. The full financial impact of the harmful product may not necessarily have hit the manufacturer’s financial statements yet, but past experience makes clear that over time, more and more victims will sustain injuries and will sue. Ignoring these future tort liabilities would mean the eventual operational collapse of the manufacturer.

The case presents the daunting task of structuring mechanisms to assure fair and adequate compensation to future tort victims consistent with due process, while at the same time preserving the going concern value of the tortfeasing company, upon which future claimants may depend for their future

138 NBRC REPORT, supra note 117, at 327.

139 As the cloud of future liability becomes darker and darker, financing would be more and more difficult to obtain. Doubts about the continuing viability of the business would grow. Customers and suppliers would defect. Rather than wait for this slow death to overtake the business, the firm actively seeks a global solution to the overhanging future liabilities. Bankruptcy is an attractive option. See Roe, Mass Tort, supra note 2, at 856-862 (describing slow process of operational collapse for company beset by mass future tort liabilities which inhibit its access to capital markets).

The other option which has been tried to date is the settlement class action. That is a class action initiated by the defendant, the manufacturer, for the purpose of settling future claims. The potential for conflicts of interest is of course high, and perhaps fatal. See, e.g., Amchem Prods., Inc. v. Windsor, 117 S.Ct. 2231 (1997) (affirming denial of certification to proposed settlement class). See generally Coffee, Class Wars, supra note 2; Coffee, The Corruption of the Class Action, supra note 2.
compensation. The identities of many or most future claimants and the extent of their injuries or other harm may not be known at the time of bankruptcy.\textsuperscript{140} The basic problem for the debtor manufacturer is to fix or at least cap the aggregate amount of contingent liability, and then to set aside or arrange for some fixed pool of assets that will be used to pay future claims as they arise.

A “traditional” model emerged to resolve these issues. It has several novel components.\textsuperscript{141} To address notice and other due process problems, the debtor obtains appointment of a special legal representative for future claimants, who typically cannot represent themselves.\textsuperscript{142} Complex estimation

\textsuperscript{140} For example, exposure to asbestos may lead to emphysema, mesothelioma, and lung cancers. However, it would be impossible to identify or locate every person ever exposed to asbestos, given the popularity of its use as an insulating material from the 1950s to the 1970s. \textit{See} Coffee, \textit{Class Wars}, supra note 2, at 1429 (noting that “virtually every U.S. citizen has been exposed to asbestos.”). In addition, not every person exposed to the substance will manifest ill effects. The degree of exposure and other environmental factors will matter.

With a product like intrauterine devices (A.H. Robins) or breast implants (Dow Corning), identification of potential tort claimants may be less problematic. Potential victims of those products could more readily self-identify in response to widespread publication notice. Some could conceivably be identified through medical records. The difference is really one of degree. Even if future claimants could self-identify though, there remains the problem of getting healthy future claimants to appreciate the significance of legal proceedings that will only matter to them in the event of future manifestation of injury. \textit{See supra} note 10 and accompanying text.

\textsuperscript{141} This model was also followed in at least one case not involving a mass tort situation—that is, where future tort claims were not the primary factor precipitating bankruptcy. In the external reorganization of Piper Aircraft, a legal representative was appointed, future claims were dealt with in the liquidating plan via a trust fund device, and a channeling injunction was issued in connection with the plan confirmation. \textit{See} Piper Disclosure Statement, \textit{supra} note 12. While future claims liability was an important concern in the case, poor management was apparently at least as significant a cause of the company’s demise. \textit{See id.} at 11-12 (describing “devastating consequences” of key business decisions of prepetition management).

\textsuperscript{142} \textit{See}, \textit{e.g.}, In re Johns-Manville Corp., 36 B.R. 743 (Bankr. S.D.N.Y. 1984)(appointing representative for asbestos-exposed future claimants, who are parties in interest); In re Amatex Corp., 755 F.2d 1034 (3d Cir. 1985)(same). Some courts, however, refused to appoint future claims representatives. \textit{See}, \textit{e.g.}, Locks v. U.S. Trustee, 157 B.R. 89 (W.D. Pa. 1993), discussed \textit{infra} note 151.
proceedings are conducted in order to value future claims and fix the manufacturer’s aggregate liability.\textsuperscript{143} A claims resolution facility is structured to streamline claims liquidation and disburse payments as future claims mature.\textsuperscript{144} A trust device is employed to manage the assets that will be the source of such payments.\textsuperscript{145} A “channeling injunction” enjoins future claimants from pursuing

\begin{itemize}
\item \textsuperscript{143} \textit{See}, e.g., In re Eagle-Picher Ind., Inc., 189 B.R. 681 (Bankr. N.D. Ohio 1995) (estimating both prepetition and future asbestos claims for distribution purposes). \textit{See also} Dow Corning, 211 B.R. 545 (discussing merits of competing estimation proposals).
\item While the Code specifically contemplates court estimation of contingent or unliquidated claims, estimation is specifically authorized only for purposes of allowance, \textit{see} 11 U.S.C. § 502(c) (1994), and voting. \textit{See} FED. R. BANKR. P. 3018(a) (court may temporarily allow claim “in an amount which the court deems proper” for voting purposes). Claim allowance determines which claims may validly participate in the case. Only claims that are “allowed” are entitled to vote on the terms of reorganization, \textit{see id.}, § 1126, and receive distributions. \textit{See id.}, § 726.
\item Estimation for purposes of distribution is not specifically authorized in the Code or the Bankruptcy Rules. Both the National Bankruptcy Conference and the National Bankruptcy Review Commission have recommended statutory amendments clarifying that courts may estimate claims for purposes of distribution. The latter applies, however, only to mass future claims. \textit{See} NBC FINAL REPORT, \textit{supra} note 117, at 285; NBRC REPORT, \textit{supra} note 117, at 341.
\item In \textit{Piper}, the claim resolution process included mandatory pre-trial mediation, as well as a binding arbitration alternative to litigation. \textit{See} Piper Disclosure Statement, \textit{supra} note 12, at 138-39.
\item The Claims Resolution Facility created by the \textit{Robins} plan—while not necessarily ideal in its implementation, \textit{see} SOBOL, \textit{supra} note 10, at 309-25 (providing scathing appraisal of judge’s manipulation of supposedly independent claims resolution facility and associated trust)—provides an interesting framework of procedural choices. It offers several different claim processing options, ranging from a “short form,” which pays the electing claimant a nominal amount upon a minimal showing of Dalkon Shield use and injury, to a fairly elaborate settlement process involving in-depth review of the claim, including the electing claimant’s medical records. Should the process fail to produce settlement, the claimant may resort to binding arbitration or trial. \textit{See} Sixth Amended and Restated Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code, March 28, 1988 (In re A.H. Robins Co. Inc.)(No. 85-01307-R), at CRF 1-9 [hereinafter Robins Disclosure Statement].
\item \textit{See also} Mark A. Peterson, \textit{Giving Away Money: Comparative Comments on Claims Resolution Facilities}, 53 LAW & CONTEMP. PROBS. 113 (1990) (comparing differing features and objectives of several claims resolution facilities).
\item \textit{See, e.g.}, In re Joint Eastern and Southern District Asbestos Litigation (In re Johns-Manville), 982 F.2d 721 (2d Cir. 1992) (describing plight of Manville Trust), \textit{modified}, 993
\end{itemize}
the reorganized debtor or any successor to the debtor’s business or assets. Instead, future claims are channeled to the designated payment trust, and the going concern is insulated from postbankruptcy suit by future claimants.146

The costs of this traditional approach have run into the tens of millions of dollars.147 However, given the size of the debtors, the sheer numbers of future claimants and other creditors, and the staggering amounts of liability, one might expect that comprehensive resolution would not come cheap.148 Moreover, the large stakes involved suggest both far-reaching consequences of operational collapse and that avoiding such consequences may be worth a

F.3d 7 (2d Cir. 1993). See generally Roe, Mass Tort, supra note 2, at 864 (describing payment devices to manage uncertainty regarding aggregate claims liability).

146 See, e.g., In re Johns-Manville Corp., 68 B.R. 618, 625 (Bankr. S.D.N.Y. 1986) (holding that bankruptcy court has equitable power to issue channeling injunction), aff’d sub nom., Kane v. Johns-Manville Corp., 843 F.2d 636 (2d Cir. 1988); In re A.H. Robins Co., 88 B.R. 742 (E.D. Va. 1988) (enjoining suit against successor corporation, among others), aff’d sub nom., Menard-Sanford v. Mabey (In re A.H. Robins Co.), 880 F.2d 694 (4th Cir. 1989); Piper Disclosure Statement, supra note 12, at 112 (describing channeling injunction). Of these three cases, only Piper involved an asset sale. Manville was internally reorganized, and the channeling injunction was used to insulate the reorganized debtor and others from suit by future claimants. Johns-Manville, 68 B.R. at 624. In Robins, the debtor was merged into another entity as part of the plan. That surviving entity and others were the beneficiaries of the channeling injunction. A.H. Robins, 88 B.R. at 751.

147 See Trust Officials Report Surge in Claim Filings in 1994, Mealey’s Litigation Report: Asbestos, March 17, 1995 (reporting that for 1994, Manville Trust operating expenses totaled $8.1 million, and total expenses were approximately $14.7 million); Findley v. Blinken (In re Joint Eastern and Southern Dists. Asbestos Litig.), 129 B.R. 710, 750 (E. & S.D.N.Y. 1991), vacated, 982 F.2d 721 (2d Cir. 1993), modified 993 F.2d 7 (2d Cir. 1993) (describing costly process of resolving asbestos claims in several cases, and noting specifically that “[t]he Manville Trust, designed to fairly and expeditiously compensate personal injury claimants was spending approximately one million dollars a week on outside counsel litigation defense costs alone in 1990 in addition to its own staff counsel and overhead costs at a time when it had almost no unrestricted cash.”); Francis E. McGovern, Resolving Mature Mass Tort Litigation, 69 B.U.L. Rev. 659, 686 (describing costs of claims estimation process in A. H. Robins bankruptcy, and noting that the data collection process alone cost $5 million, and that “the estimation process represented the largest and most expensive social science survey ever conducted under the auspices of a court.”).

148 Cf. John A. Siliciano, Mass Torts and the Rhetoric of Crisis, 80 Cornell L. Rev. 990, 1000-05 (questioning claims that transaction costs of mass torts are “too high”).
significant investment.\textsuperscript{149} Given these stakes, innovative solutions are possible that might be cost prohibitive in other circumstances.\textsuperscript{150}

\textsuperscript{149} Whether debtor rehabilitation \textit{should} be a goal of Chapter 11 is the subject of some debate. \textit{See} Baird \& Jackson, \textit{supra} note 93. However, that it currently \textit{is} a goal cannot be gainsaid.

\textsuperscript{150} The legal basis for this overall approach is not free from doubt. \textit{See} NBC \textsc{Final Report}, \textit{supra} note 117, at 281, and NBRC \textsc{Report}, \textit{supra} note 117, at 315, which describe the current legal uncertainty relating to this “traditional” model for treating future claims in the mass liability context, as well as legislative proposals to address this uncertainty. In the mass tort asbestos cases, even Congress was solicited to provide specific benediction. \textit{See} 11 U.S.C. § 524(g) (1994) (authorizing, both retroactively and prospectively, issuance of channeling injunction in asbestos case, provided, \textit{inter alia}, that trust is created to pay future claims).

Actual results to date have also not been without controversy. These schemes have sometimes been subverted in the implementation—largely in the valuing or allowance of future claims—in order to guaranty survival of the going concern and more than nominal returns to equityholders, which of course comes at future claimants’ expense. \textit{See e.g.}, In re Dow Corning Corp., 211 B.R. 545, 599 and n.56 (Bankr. E.D. Mich. 1997) (“The failure of the traditional model, which was first crafted in Johns-Manville, is widely recognized.”), and sources cited therein; Mabey \& Zisser, \textit{supra} note 117, at 495-96 (explaining favoritism of current claims over future claims in structuring of Manville Trust); Findley v. Blinken (In re Joint Eastern and Southern Dists. Asbestos Litig.), 129 B.R. 710, 754-762 (E. \& S.D.N.Y. 1991), \textit{vacated} 982 F.2d 721 (2d Cir. 1992), \textit{modified} 993 F.2d 7 (2d Cir. 1993)(describing problem of massive underfunding of Manville Trust); \textsc{Sobol}, \textit{supra} note 10, at 309-325 (describing judge’s manipulation of purportedly independent Claimants Trust in order to assure “accuracy” of court’s prior estimate in A.H. Robins bankruptcy).

Nevertheless, there may be some basis for optimism concerning the traditional model. As Professors Warren and Westbrook aptly note:

\begin{quote}
[G]iven the novel use of bankruptcy laws to address a massive social problem that Congress and other institutions refused to address, it could be argued—as Dr. Johnson said of the dog walking on its hind legs—that the wonder was not that it was done badly, but that it was done at all.
\end{quote}

\textsc{Warren \& Westbrook}, \textit{supra} note 95, at 799. Given the value at stake in the large cases and active public scrutiny of their outcomes, as well as the attention of reform proponents aimed at mass future liability issues, we may be optimistic that legal clarity will evolve and that implementation of the model will improve. For examples of innovation, \textit{see} Smith, \textit{supra} note 8 (describing use of capital markets as solution to problems of estimation and distribution with respect to future claims.); Dow Corning, 211 B.R. at 603 (describing Professor Smith’s capital markets approach and urging its consideration by the parties); Michael J. Saks \& Peter David Blanck, \textit{Justice Improved: The Unrecognized Benefits of Aggregation and Sampling in the Trial of Mass Torts}, 44 \textsc{Stan. L. Rev.} 815 (1992) (arguing that aggregation and sampling produces more precise and reliable outcomes than individualized bilateral trials).
2. Pragmatism with Future Claims

Future claims in the run-of-the-mill case raise the same conceptual difficulties as in the mass tort context. However, for small and medium-sized companies, the economics are quite different, and future tort liabilities may not necessarily be the central issue in bankruptcy. In this context, administration of future claims may be relatively expensive. Even if there is going concern value and it is successfully salvaged, resort to the traditional model would likely generate significant fixed costs disproportionate to the size of the case or any expected benefit to future claimants.\footnote{Even for a large debtor, which may be able to bear significant administrative expenses, whether a viable going concern can be salvaged may not be clear at the outset of the case. If piecemeal liquidation turns out to be the result—and any optimism concerning any going concern value turns out to have been unfounded—then an inordinate amount of scant liquidation proceeds may be consumed by the administrative costs of including future claims, leaving only a relatively small residue for actual distribution to current and future claimants. For example, in \textit{Locks v. U.S. Trustee}, 157 B.R. 89 (W.D. Pa. 1993), the court refused to appoint a legal representative for future claims because the debtor was liquidating. Since there would be no business left to save from overhanging future claims liability, the court was unwilling to recognize future claimants as creditors, citing among other reasons the administrative costs of maintaining a facility to pay future claims and the minimal dividend they would receive. Future claims received no consideration. \textit{Id.} at 99. \textit{But see} \textit{In re Forty-Eight Insulations, Inc.}, 58 B.R. 476 (Bankr. N.D. Ill. 1986), in which the court appointed a future claims representative even though the debtor was liquidating. “[I]t would be highly inequitable to distribute the liquidated assets of the debtor to the currently known plaintiffs to the detriment of the potential claimants merely because the potential claimants have not yet manifested an injury.” \textit{Id.} at 477.}

On the other hand, no alternative approach seems to have developed. Given the smaller stakes and fewer resources involved and the possibly incidental nature of the future claims liability, ignoring future claims may be a tempting alternative to dealing with them. The immediate pressures to rehabilitate the business, rescue jobs, preserve firm-specific capital like...
customer- and supplier relationships, all conspire to overwhelm any attempt at fair and equitable treatment of faceless, nameless future victims. As previously discussed, this often happens in practice.

\[\textit{a) “Creditors” and “Claims”: The Statutory Issue}\]

Courts have wrestled over the fundamental question whether or not future claimants qualify as “creditors” that can be dealt with in bankruptcy. Consistent with the notion of separating the debtor’s past from its future, only if their claims “arise” before bankruptcy may future claimants be considered creditors. And a close reading of the Bankruptcy Code suggests that only creditors are eligible to participate in bankruptcy and share in bankruptcy

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153 See supra note 115 and accompanying text.

154 A creditor is “an entity that has a claim against the debtor that arose at the time of or before the order for relief,” 11 U.S.C. § 101(10)(A) (1994), which for a voluntary petition occurs upon the filing of the petition. Id., § 301. The legislative history makes clear that “‘creditor’ is defined to include only holders of prepetition claims against the debtor.” See H. R. REP. NO. 595, 95th Cong., 1st Sess. 309-310 (1977) [hereinafter HOUSE REPORT].

Section 101(5) defines “claim” as

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.


If future claims are deemed not to arise prebankruptcy, then bankruptcy would seem ineffective to address or affect future claimants’ rights.

This question is a tricky one. The definition of “claim” includes contingent and unmatured rights to payment, and legislative history suggests that Congress intended to be quite inclusive in defining the types of obligations that could be included. However, courts disagree as to the proper construction of these critical terms. Several different approaches have been discussed for

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156 A proof of claim may be filed only by or on behalf of a creditor, 11 U.S.C. § 501, the allowance of the claim will be determined as of the petition date, id., § 502, and only such allowed claims may share in the bankruptcy distribution, id., § 726, and vote on the Chapter 11 plan. Id., § 1126. The terms of a Chapter 11 plan bind “any creditor,” id., § 1141(a), and confirmation of a Chapter 11 reorganization plan discharges only preconfirmation debts. Id. § 1141(d)(1)(A). In addition, only prepetition claims are subject to the automatic stay. The filing of a bankruptcy petition stays collection efforts only as to claims which “arose before the commencement of the case.” 11 U.S.C. § 362(a)(1).

157 A related issue involves the interim claim, which first becomes apparent during the course of the case. For example, the tort victim using the debtor’s defective product manufactured prepetition, who sustains injury after the petition has been filed but before confirmation, has been identified in time to assert a claim in the case. Courts have struggled over the question whether this is a prepetition claim or not, as the automatic stay applies only to a claim which “arose before commencement of the case.” 11 U.S.C. § 362(a)(1). Cf. Grady v. A.H. Robins Co., Inc. (In re A.H. Robins Co., Inc.), 839 F.2d 198 (4th Cir. 1988) (holding that even though injury from Dalkon shield arose postpetition, plaintiff’s held prepetition claim subject to stay where tortious acts giving rise to liability were performed prepetition), with Pettibone Corp. v. Ramirez (In re Pettibone Corp.), 90 B.R. 918 (Bankr. N.D. Ill. 1988) (holding that although allegedly defective product manufactured prepetition, no prepetition relationship existed; therefore, plaintiff held postpetition claim not subject to stay. Court might, however, consider issuing injunction staying plaintiff’s suit in reliance on § 105(a)).

As a practical matter, this type of claim should not trouble us much. It does not raise the serious problems of the sort implicated by “true” future claims, i.e., those for which the identity of the claimant or the fact of injury cannot be determined until after the bankruptcy has concluded. However, as the cases cited in the preceding paragraph suggest, cases involving interim claims often result in rulings that affect treatment of future claims as well. See also Davis, supra note 115, at 337 (coining the phrase “interim claim”).

158 See supra note 154.

159 “By this broadest possible definition, . . . the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.” HOUSE REPORT, supra note 154, at 309.
determining when future claims arise. Of these, the conduct test is probably the most conceptually appealing. Under that test, if the debtor’s conduct giving rise to the eventual liability has already occurred by the time the petition is filed, then claims for the future injuries resulting from that prepetition conduct are deemed prebankruptcy claims.

The conduct test is most appealing simply because it effects the

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Courts sometimes describe the issue as one of determining whether particular rights qualify as “claims,” when a close reading of the statutory definitions suggests that the issue is one of timing—that is, when does a particular claim arise. See Heidt, Changing Paradigm, supra note 11, at 1059 n.10.

161 See Grady v. A.H. Robins Co., Inc. (In re A.H. Robins Co., Inc.), 839 F.2d 198 (4th Cir. 1988) (holding that even though injury from Dalkon shield arose postpetition, plaintiff’s held prepetition claim subject to stay where tortious acts giving rise to liability were performed prepetition); Waterman S.S. Corp. v. Aguiar (In re Waterman S.S. Corp.), 141 B.R. 552 (Bankr. S.D.N.Y. 1992) (adopting conduct test in asbestos case), vacated on other grounds, 157 B.R. 220 (S.D.N.Y. 1993).

In addition to the conduct test, other plausible tests have been discussed. The accrued state law claim test is the narrowest. Under this test, a claim is deemed to arise only when a cause of action accrues under state law. See In re M. Frenville Co., 744 F.2d 332 (3d Cir. 1984). In the product liability context, this would mean that no bankruptcy claim arises until some cognizable harm has occurred. Therefore future claims would not be included. This narrow approach has been “roundly criticized.” See Jensen v. California Dep’t of Health Servs. (In re Jensen), 127 B. R. 27, 30 (BAP 9th Cir. 1991), aff’d, 995 F.2d 925 (9th Cir. 1993); In re Transportation Sys. Int’l, 110 B.R. 888, 894 (D. Minn. 1990).

The conduct test is the broadest test. Tests of intermediate breadth have also developed. The Piper test requires not only prepetition conduct but also the existence of some preconfirmation relationship between the debtor and the tort victim. See Epstein, 58 F.3d 1573 (only those parties asserting claims based on debtor’s prepetition conduct and having preconfirmation relation with debtor deemed to hold bankruptcy claims). The fair contemplation test requires that the claim be within the “fair contemplation” of the parties at the time of bankruptcy. See California Dep’t of Health Servs. v. Jensen (In re Jensen), 995 F.2d 925, 930 (9th Cir. 1993).
separation of the debtor’s past from its future and enables comprehensive relief from the debtor’s past blunders.162 And only a conduct test enables all those affected by the debtor’s past blunders to receive equal treatment.163 A less inclusive test might not suffice.

Unfortunately, the conceptual clarity of the inclusive conduct test belies the difficult practical consequences that may result. The test effectively requires a mandatory approach. If prepetition liability-creating conduct is sufficient to confer prebankruptcy “claim” status, then future claims must be dealt with in all bankruptcy cases, regardless of the size of a given case, the reason for the filing, or whether the debtor ultimately reorganizes internally or externally or liquidates piecemeal.164 This seems fair conceptually, but as previously discussed, the transaction costs generated may be prohibitive.

b) Judicial Pragmatism

Perhaps reflecting the disharmony between conceptual clarity and

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162 See Heidt, Changing Paradigm, supra note 11, at 1084 (asserting that only conduct test effects appropriate separation of debtor’s past and future); Jackson, Translating Assets and Liabilities, supra note 117, at 82 (stating that future claims based on debtor’s past acts that are cognizable under state law and have some value at time of bankruptcy should be treated as prebankruptcy claims); Keating, supra note 96, at 1098 (arguing that only conduct test works in solving state law collective action problem). See also supra note 122 and accompanying text. This test should require relatively specific identification of the particular harm- or obligation creating conduct which is meant to be addressed. This requirement prevents open-ended discharge of obligations and avoids concomitant due process problems. See NBC Final Report, supra note 117, at 283-84.

163 See supra notes 124-126 and accompanying text.

164 The current Code provides no flexibility in this regard. Reform proposals adopt variants of the conduct test, see NBC Final Report, supra note 117, at 283-84 (proposing conduct-based test); NBRC REPORT, supra note 117, at 326 (espousing conduct-based test); Davis, supra note 115, at 361 (espousing preconfirmation conduct test); but also include provisions that would allow future claims to be excluded despite their status as prebankruptcy claims. See discussion supra note 131.
practical messiness, the courts have handled this issue in result-oriented fashion more or less: include future claims if necessary to save the business,\textsuperscript{165} exclude them if not,\textsuperscript{166} and hedge if unclear. In \textit{Amatex},\textsuperscript{167} the court hedged. It proclaimed that whether or not future claims are deemed to arise prebankruptcy, future claimants are at least “parties in interest,” if not creditors. Therefore, appointment of a legal representative in Chapter 11 was justified.\textsuperscript{168}

In \textit{Piper},\textsuperscript{169} the future claims issue was a moving target. Initially, at the behest of a prospective acquirer, the debtor sought appointment of a future claims representative.\textsuperscript{170} It seemed unlikely that a buyer could be found unless

\textsuperscript{165} See Grady, 839 F.2d 198; Waterman, 141 B.R. 552, discussed \textit{supra} note 161. \textit{See also} In re UNR Ind., Inc., 725 F.2d 1111, 1118-19 (7th Cir. 1984) (Posner, J.), in which the court questioned the correctness of district judge’s view that future asbestosis claimants have no rights in bankruptcy, and suggesting that even assuming future claims may not qualify as statutory prebankruptcy claims, the court’s equitable powers “just might be broad enough to enable the court to make provision for” such future claims in the plan of reorganization. \textit{Id.} at 1119; Roach \textit{v.} Edge (In re Edge), 60 B.R. 690 (Bankr. M.D. Tenn. 1986) (adopting conduct test as basis for holding, in dentist’s chapter 7 case, that automatic stay applied to patient’s injury discovered postpetition but caused by debtor-dentist’s prepetition negligence).

\textsuperscript{166} See, \textit{e.g.}, \textit{Piper}, 162 B.R. at 628 (rejecting conduct test in part because of debtor’s view that going concern sale could be effected without inclusion of future claims); Locks \textit{v.} U.S. Trustee, 157 B.R. 89 (W.D. Pa. 1993), discussed \textit{supra} note 151.

\textit{But see} Fairchild Aircraft Inc \textit{v.} Cambell (In re Fairchild Aircraft Corp.), 184 B.R. 910 (Bankr. W.D. Tx. 1995) (finding, in airplane manufacturer’s bankruptcy, that failure to afford notice and due process to future claimants—or any consideration at all in bankruptcy proceeding—requires finding that they are not bankruptcy claims and their successor liability rights survive).

\textsuperscript{167} In re \textit{Amatex Corp.}, 755 F.2d 1034 (3d Cir. 1985).

\textsuperscript{168} \textit{Id.} at 1041 (finding that whether or not future asbestos claimants held prepetition claims, they at least qualified as parties in interest entitled to appointment of a representative in the debtor’s Chapter 11 proceeding). \textit{See also} In re Johns-Manville Corp., 36 B.R. 743 (Bankr. S.D.N.Y. 1984) (same analysis).

\textsuperscript{169} Epstein \textit{v.} Official Committee of Unsecured Creditors (In re \textit{Piper Aircraft Corp.}), 58 F.3d 1563 (11th Cir. 1995).

\textsuperscript{170} The prospective purchaser, Pilatus Aircraft Limited, had signed a letter of intent with the
future products liabilities of the extant fleet were addressed in the bankruptcy and successor liability risks eliminated, and formal representation of future claimants was thought necessary to bind them to any plan.\textsuperscript{171} In the order appointing Professor David Epstein as the future claims representative, the court was willing to define a class of future claimants based on the conduct test.\textsuperscript{172} However, the court expressly refused at that point to decide whether that class held prebankruptcy claims under the Code.\textsuperscript{173}

Professor Epstein later filed a proof of claim for $100,000,000 on behalf of his broad class of future claimants, the estimate of future liability having been gleaned from a study prepared by the debtor’s actuary.\textsuperscript{174} The debtor, the Committee and several prospective acquirers objected, however.\textsuperscript{175}

\begin{itemize}
\item \textsuperscript{171} \textit{Id.} at 622 n.3.
\item \textsuperscript{172} The class of Future Claimants was defined to include:
\begin{quote}
All persons, whether known or unknown, born or unborn, who may, after the date of confirmation of Piper’s Chapter 11 plan of reorganization, assert a claim or claims for personal injury, property damages, wrongful death, damages, contribution and/or indemnification, based in whole or in part upon events occurring or arising after the Confirmation Date, including claims based on the law of product liability, against Piper or its successor arising out of or relating to aircraft or parts manufactured and sold, designed, distributed or supported by Piper prior to the Confirmation Date.
\end{quote}
\item \textsuperscript{173} \textit{Id}.
\item \textsuperscript{174} Letter from Professor David Epstein, The University of Alabama School of Law, to author, dated April 1, 1998 [hereinafter Epstein Correspondence] (on file with author).
\item \textsuperscript{175} Piper, 162 B.R. at 622. Pilatus, the prospective acquirer that had requested appointment of a future claims representative, sided with Professor Epstein. \textit{Id.} at 623.
\end{itemize}
By that point, the debtor and Committee believed that a buyer could be found even without addressing future claims.\textsuperscript{176} The court disallowed the proof of claim, holding that not all future claims qualified as prebankruptcy claims. Unwilling to countenance the notion that unidentifiable future tort victims could or should be included in the bankruptcy proceeding, the court rejected Professor Epstein’s proposed conduct test, finding its scope overbroad.\textsuperscript{177}

Instead, the court adopted a preconfirmation relationship test. That the liability at issue was based on the debtor’s prepetition conduct was not sufficient to make it a prebankruptcy claim. In addition, the existence of a preconfirmation relationship between the debtor and claimant was required.\textsuperscript{178} Professor Epstein’s proposed class did not qualify.\textsuperscript{179}

The conclusion to the case provides a further irony. The liquidating plan that was ultimately confirmed with Professor Epstein’s support adopted his broad definition of future claims—implicitly adopting a conduct test—and provided for future claims on a par with current claims.\textsuperscript{180} Professor Epstein’s original approach was vindicated.

\textsuperscript{176} Piper, 162 B.R. at 622 n.3.

\textsuperscript{177} Id. at 628.

\textsuperscript{178} Such a relationship could be based, for example, on contact, exposure, impact or privity. Epstein, 58 F. 3d at 1577. The bankruptcy court had originally required a \textit{prepetition} relationship. This position it later modified as a result of an adversary proceeding, see Piper v. Calabro (In re Piper Aircraft Corp.), 169 B.R. 766 (Bankr. S.D. Fla. 1994), and the court of appeals affirmed the test as modified. Epstein, 58 F.3d at 1577 and n.5.

\textsuperscript{179} Id. Of course, some subset of Professor Epstein’s proposed class would have qualified under the court’s test. But the class itself, structured as it was around the conduct test, was defined too broadly for the court’s liking.

\textsuperscript{180} See Piper Disclosure Statement, \textit{supra} note 12, at 53.
However, this outcome was not so much a triumph of principle as one of politics. Critical to the consensual resolution of the case\textsuperscript{181} was the enactment by Congress of the General Aviation Revitalization Act of 1994.\textsuperscript{182} This statute of repose prohibits products liability suits against manufacturers of general aviation aircraft for accidents involving aircraft more than eighteen years old.\textsuperscript{183} The effect of this statute on the \textit{Piper} bankruptcy was to reduce significantly the debtor’s aggregate future claims liability, thereby leaving enough value to satisfy all parties. The law became effective at an opportune moment in the case—while the bankruptcy court’s decision disallowing Professor Epstein’s claim was making its way on appeal to the Eleventh Circuit.\textsuperscript{184}

\textbf{D. A Flexible Approach in External Reorganization}

Given the different consequences of including future claims in the different types of cases, a flexible approach has superficial appeal. If bankruptcy’s goal is to rehabilitate troubled companies, why not simply allow for inclusion or exclusion of future claims depending on the particular needs of the

\textsuperscript{181} Epstein Correspondence, \textit{supra} note 174.


\textsuperscript{183} \textit{Id.} at 2, 3. Our hypothetical future claimant, \textit{see supra} pp. 1-2, would not be affected, since she was not aboard the plane that caused her harm. \textit{Id.} at 2(b)(3). The definition of “general aviation aircraft” is limited to aircraft that carry fewer than twenty people and were not engaged in passenger carrying operations at the time of the accident. \textit{Id.} at 2(c). Component manufacturers are also covered. \textit{Id.} at 2(a). Repose is not available where (i) the manufacturer knowingly misrepresents or conceals safety information from the Federal Aviation Administration; (ii) the claimant was a passenger for purposes of receiving medical or emergency treatment; (iii) the claimant was not aboard the aircraft at the time of the accident; or (iv) the claimant’s cause of action is based on the manufacturer’s written warranties. \textit{Id.} at 2(b)(1)-(4).

\textsuperscript{184} Telephone interview with Professor David Epstein (April 8, 1998).
case? After all, if future claimants are not included, then their formal legal rights are not affected. Their rights outside of bankruptcy are preserved, so they are not harmed by their exclusion from the proceeding.

1. **Internal v. External Reorganization**

The flexible approach may do no harm in internal reorganization, but with respect to external reorganization, the above depiction ignores the liability avoidance strategies available under a flexible approach.

**a) A Note on Internal Reorganization**

Flexibility to exclude future claims may be acceptable in internal reorganization, since the reorganized debtor survives to answer for claims—future or otherwise—that were not included. While such omitted claims, if valid, will collect 100-cent dollars from the reorganized debtor, the impact on other creditors and their collective settlement may be negligible, or at least acceptable.

The transaction cost savings from not including future claims may more than make up for the costs to the reorganized debtor—and the indirect cost to current creditors in terms of the reduced value available for distribution—of having to pay future claims in full as they mature postbankruptcy. The aggregate amount of future claims liability—especially when discounted to present value—

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185 Claimants’ right to due process under the Fifth Amendment precludes their discharge based on a bankruptcy proceeding of which they received no notice and were otherwise excluded. See Dalton Dev. Project #1 v. Unsecured Creditors Comm. (In re Unioil), 948 F.2d 678 (10th Cir. 1991); Reliable Electric Co., Inc. v. Olson Construction Co., 726 F.2d 620 (10th Cir. 1984). If future claims are included, then they should be discharged along with current claims.
may not be worth the fuss of attempting to account for it in reorganization. In that situation, all are better off if future claims are simply paid by the reorganized debtor as those claims mature.

If future claims liability imperils the survival of the business, then future claims should be addressed explicitly in the internal reorganization. However, in many if not most cases, survival of the business will not depend on treating future claims. In those cases, aside from the transaction cost savings, excluding future claims is essentially a distributional issue to which the nominally disadvantaged parties—current creditors—may consent. Current creditors will be present to participate in the reorganization and to voice any objections they might have. In such a situation, omitting future claims may make sense. When transaction costs are considered, a flexible approach becomes plausible for internal reorganization.

b) **Opportunism in External Reorganization**

External reorganization, however, is different. As in the nonbankruptcy context, future claimants excluded from external reorganization may have no recourse against the going concern that survives. As with the going concern sale outside of bankruptcy, the debtor sells the business to a third party,

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186 On the other hand, if the internal reorganization effort fails, as most do, then future claims should be included. *See infra* note 223.

Note that this tentative approval of a flexible approach in internal reorganization does not suggest that future claimants are not creditors or that their rights are somehow more malleable in bankruptcy than those of other creditors. To the contrary, future claimants’ rights as creditors are fully recognized.
sale proceeds are distributed, and only the empty corporate shell remains.\textsuperscript{187}

Given that the firm’s creditors—both current creditors and future claimants—are the firm’s residual owners, it is largely current creditors’ interests that are at stake in the issue of whether future claims are included. And that issue is decided among the debtor’s management, current creditors and the prospective acquirer, without input or participation by unrepresented future claimants.\textsuperscript{188}

Much like the shareholders of the target firm outside of bankruptcy, current creditors, as the debtor’s residual claimants, will attempt to structure a deal with the acquirer that maximizes returns to them. This may not always coincide with maximizing sale proceeds or returns to creditors overall. Current creditors will push for inclusion of future claims only when it is to their benefit.\textsuperscript{189}

\section*{2. Current Creditors’ Calculus}

When will future claims be included? Even assuming away

\textsuperscript{187} As with asset sales outside of bankruptcy, future claimants’ rights against the bankruptcy acquirer will depend on state law successor liability rules.

\textsuperscript{188} Absent appointment of a legal representative, future claimants are not represented. \textit{But see} Amatex, 755 F.2d at 1040 (professed future claimant appeared, seeking to intervene in opposition to appointment of legal representative). But appointment of a representative does not occur spontaneously. It occurs at the behest of a party that \textit{is} represented in the bankruptcy, which suggests that no representative will be appointed for future claimants unless some other party stands to benefit.

\textsuperscript{189} Current creditors will not be able to dictate the form of the asset disposition. That decision is nominally the debtor’s, although the court will certainly hear creditors’ views in the process of approving the sale. \textit{See infra} notes 240-241 and accompanying text. However, once the decision is made to sell the assets, the debtor’s management has no strong stake in the outcome. Absent side payments from an acquirer—for example, the promise of a post-sale consulting contract—management has basically thrown in the towel by that point.
transaction costs of including future claims, current creditors have incentive to exclude them under certain conditions. Current creditors’ calculus will proceed along the following lines.

As in the nonbankruptcy context, the acquirer will pay a higher price for an enterprise free of the threat of successor liability than otherwise. Current creditors stand to benefit insofar as their distributions improve because of the acquirer’s willingness to pay “full price” for “clean” assets. But this also means that current creditors have to share the sale proceeds with future claimants. For the clean going concern sale, current creditors will calculate their return as follows.

If we let:

1. LV equal the piecemeal liquidation value of the assets; that is, the scrap value;
2. GW equal the goodwill of the business; that is the incremental value of the going concern over and above the scrap value;
3. CC equal the aggregate amount of allowed current claims; and

\[ \text{Return} = LV + GW - CC \]

\[ \text{Return} = LV + GW - CC \]

190 Initially, I consider current creditors’ calculus—and the likelihood of future claimants’ inclusion—absent transaction costs. I also assume no secured debt and no general administrative expenses. These latter assumptions are purely for ease of exposition and do not affect the analysis. I later reintroduce transaction costs and draw some general conclusions as to their effect on current creditors’ strategies and future claimants’ prospects. See infra Part IV.D.4

191 The formulae that follow are not meant to imply mathematical precision to a calculus that must unavoidably incorporate estimates and perhaps downright guesses. In fact, the only figure susceptible of easy estimation may be the aggregate amount of current claims (CC). Nonetheless, the formulae illustrate relationships among the various considerations that will affect current creditors’ strategizing about whether and when to include future claims in external reorganization.

192 While the current state of the law offers no guaranties in this regard, certainly the chances of successfully eliminating future claimants’ successor liability claims are much better if future claims are accounted for in the bankruptcy proceeding. See infra Part V.A.
4. FC equal the estimated aggregate amount of allowed future claims liability, discounted to present value; then, in a pro rata distribution among current and future claims, the payout ratio for each current and future claim (which we will refer to as \( R_c \)) is roughly

\[
R_c = \frac{LV + GW}{CC + FC}
\]

Each current and future claimant receives a bankruptcy distribution equal the amount of its allowed claim multiplied by the above fraction.\(^{193}\)

Current creditors as a group stand to receive aggregate distributions (which we refer to as \( D_c \)) equaling

\[
D_c = LV + GW - (FC)(R_c).
\]

That is, current creditors will receive the debtor's going concern value less payment to future claimants of their pro rata share of the sale proceeds.\(^{194}\)

\[a) \quad \text{The Quick and Dirty Sale}\]

Instead of the above scenario, current creditors might prefer a different deal. They might opt for a “quick and dirty” going concern sale, without including future claims in the proceeding.\(^{195}\) The acquirer runs the risk

\(^{193}\) Note that \( R_c \) is simply the going concern value of the business, divided by the aggregate dollar amount of current and future claims.

Assume, for example, the following values for a hypothetical debtor: \( \text{LV}=5; \text{GW}=7; \text{CC}=14; \text{FC}=10 \). In a clean sale of the debtor’s business, proceeds of 12 would be shared among 24 in current and future claims. \( R_c \) would therefore equal (.5).

\(^{194}\) Continuing with our hypothetical, current creditors as a group would stand to receive \( D_c \) of \( 5+7-(10)(.5) \) or 7.

\(^{195}\) Some type of free-and-clear sale order will be requested in any event, with bankruptcy courts generally willing to oblige. See infra notes 242-243 and accompanying text.
of being tagged with successor liability under state law, and will discount its 
purchase price accordingly.\textsuperscript{196} Depending on the size of the discount, current 
creditors might decide they are better off sharing a smaller pie among themselves 
than having to include future claimants in the distribution. When will this 
occur?

In the quick and dirty going concern sale, the aggregate distribution 
to current creditors (which we will refer to as $D_{qd}$) equals

$$D_{qd} = LV + GW - (FC)(P_{sl})$$

where:

1. $P_{sl}$ is the aggregate probability of imposition of successor liability. Given 
   the uneven prospects for successor liability following the sale, this 
   probability may in many cases be small.

2. $(FC)(P_{sl})$ therefore represents both the acquirer’s estimate of the ultimate 
   cost to it of successor liability and also (roughly) the discount by which it 
   will reduce its bid price for the business.\textsuperscript{197}

$D_{qd}$, then, represents the going concern value of the business less the acquirer’s 
successor liability discount.

Current creditors will prefer a quick and dirty sale to a clean one 
when $D_{qd} > D_{c}$; that is, when the aggregate distribution they stand to receive is 
higher excluding future claims than including them. This will depend largely on

\textsuperscript{196} In a world of no transaction costs and perfect information, the acquirer would be indifferent 
as between paying full price for clean assets and a discounted price in the quick and dirty sale.

\textsuperscript{197} This is of course the successor liability discount discussed supra Part II.C.1.

For simplicity’s sake, the discussion in the text assumes that current creditors enjoy all 
the incremental gains from their strategic choice of transactional form. More likely, gains 
would be shared with the acquirer in the bargaining over the purchase price, as occurs outside 
of bankruptcy. See supra note 42 and accompanying text.
Comparing the two formulae above for $D_{qd}$ and $D_c$ shows that current creditors will opt for a quick and dirty sale when $P_{sl} < R_c$, that is, when the aggregate probability of successor liability is less than the payout ratio from a clean sale. When the probability of successor liability is lower than the payout ratio to current and future claims in a clean sale, the successor liability discount $(FC)(P_{sl})$—that is, the amount of going concern value that current creditors indirectly lose to future claimants in the quick and dirty sale—is less than the amount future claimants take directly in a clean sale. So the quick and dirty sale will net higher returns to current creditors.

A simplifying assumption of comprehensive successor liability outside of bankruptcy might lead to a different analysis. See, e.g., JACkson, LOGIC AND LIMITS, supra note 93, at 50-54 (asserting that preservation of going concern value requires inclusion of future claims in bankruptcy in order to eliminate incentive of current creditors to liquidate piecemeal).

For example, if all unsecured creditors would receive a 50% payout if future claims were included, current creditors would exclude future claims when the aggregate probability of successor liability is less than 50%.

Assume for our hypothetical debtor, see supra notes 193-194, that $P_{sl} = (.2)$. The acquirer will take a successor liability discount equal to 5, and current creditors enjoy $D_{qd}$ of 5+7-2 or 10. Because $P_{sl} < R_c$, the successor liability discount (equal to 2) is less than future claimants’ share of clean sale distributions (equal to 5). Therefore $D_{qd} > D_c$, and current creditors will prefer the quick and dirty sale.

To further refine our intuitions, consider the case where applicable state law did not recognize successor liability—and therefore $P_{sl}$ were zero. There, current creditors would prefer the quick and dirty sale. Regardless of the amount of future claims liability, the sale would be effective to wipe out that liability. The acquirer would be willing to pay full price for the business, with no successor liability discount. Current creditors would enjoy this entire going concern value without having to share with future claims. In that situation, neither current creditors nor any other represented party has any incentive to include future claims. This is of course the same outcome as outside of bankruptcy under a regime without successor liability. See supra notes 41-42 and accompanying text.

More formally, they would take $LV + GW$, which is greater than their alternative going concern distribution of $LV + GW - (FC)(R_c)$.

By contrast, if successor liability were universal—and $P_{sl}$ were therefore equal to 1—then current creditors would prefer to include future claims. Assuming going concern value is
b) *The Strategic Liquidation*

In addition to the quick and dirty sale, another possible sale scenario may exclude future claims. Current creditors may decide that they can maximize their bankruptcy distributions by forcing the debtor’s piecemeal liquidation.\(^{201}\) In the piecemeal liquidation, current creditors’ aggregate distribution \(D_{\text{liq}}\) would be equal to \(LV\), the scrap value of the debtor’s assets.

Current creditors will prefer piecemeal liquidation to a clean going concern sale when \(D_{\text{liq}} > D_c\). This will hold when \(LV/CC > GW/FC\).\(^{202}\) That is to say, if the scrap value of the business relative to the aggregate amount of

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insufficient to pay all claims in full, current creditors would do better sharing with future claims the full price sale consideration that results from a clean sale, rather than keeping the entirety of the heavily discounted sale consideration that would result from a quick and dirty sale. In this latter case, the acquirer would attempt to take a successor liability discount equal to the full amount of future claims liability, since that would be the amount of future liability the acquirer could expect to face. Future claims would ultimately be paid in full from the acquirer pursuant to their successor liability rights. Current creditors would therefore take only the difference between going concern value and future claims liability. In the zero-sum game of distributing the going concern value among current and future claims, current creditors would rather include future claims, forcing them to share the pain of asset insufficiency. Excluding future claims, by contrast, would effectively grant them priority status.

More precisely, in this quick and dirty sale with \(P_{\text{sl}} = 1\), current creditors as a group would take \(LV+GW-FC\), which is less than their distribution from the clean sale, \(LV+GW-(FC)(R_c)\), assuming the debtor is insolvent. That is, the debtor’s going concern value is insufficient to pay all current and future claims in full, and therefore \(R_c < 1\).

\(^{201}\) See, e.g., Amatex, 755 F.2d at 1036, where the Creditors’ Committee opposed the debtor’s reorganization plan, which included participation by future claimants and appointment of a future claims representative. Instead, the Committee pushed for piecemeal liquidation and exclusion of future claims, arguing that future claimants are not “creditors” under the Code and therefore have no rights in bankruptcy. *Id.* at 1043. Future claims are typically, though not always, excluded in a piecemeal liquidation because of the perceived transaction costs of including them. *See supra* note 151 and accompanying text. Future claimants should be included and receive equal treatment in piecemeal liquidation, both to vindicate bankruptcy’s equal treatment norm and to eliminate current creditors’ strategic incentive to dismantle an otherwise viable going concern. *See infra* note 223.

\(^{202}\) This will not hold for our hypothetical debtor. *See supra* notes 193-194. \(LV/CC = 5/14\); \(GW/FC = 7/10\). The latter is greater than the former, and \(D_c\) of 7 is greater than \(D_{\text{liq}}\) of 5. So current creditors would not prefer piecemeal liquidation to a clean going concern sale.
current claims is greater than the goodwill of the business relative to the aggregate amount of future claims liability, then current creditors do better taking just the scrap value, rather than having to share the entire going concern value with a relatively large class of future claims.\textsuperscript{203}

Current creditors may also prefer piecemeal liquidation to a quick and dirty going concern sale, since the latter runs the successor liability risk.\textsuperscript{204} Current creditors will prefer piecemeal liquidation when $D_{\text{liq}} > D_{\text{qd}}$. This will hold when $(FC)(P_{sl}) > GW$, that is, when the successor liability discount is greater than the goodwill of the business.\textsuperscript{205} In that case, liquidation proceeds simply exceed the proceeds from the quick and dirty going concern sale, making the former a more attractive option for current creditors.\textsuperscript{206}

\footnote{Current creditors may also have to contend with managerial reluctance to dismember the business. “Dissolution . . . offends managers’ sense of professionalism, since managers view their job to be running an ongoing operation.” Fox, \textit{Economic Theory}, supra note 79, at 206. See also Mark J. Roe, \textit{Corporate Strategic Reaction to Mass Tort}, 72 VA. L. REV. 1, 8-9 (1986) (describing tendency of management to want to preserve going concern, whether such a strategy benefits creditors or shareholders).}

\footnote{While future claimants would be excluded from the bankruptcy distribution in either case, a quick and dirty going concern sale is still better for future claimants, since some might be able to recover under state law successor liability rules.}

\footnote{This will not hold for our hypothetical debtor. See supra notes 193, 200. $(FC)(P_{sl}) = 2$, while $GW = 7$. $D_{qd}$ (equal to 10) is therefore greater than $D_{liq}$ (equal to 5), and current creditors will prefer the quick and dirty sale.}

\footnote{This is the same piecemeal liquidation problem that future claimants have with the firm’s residual claimants outside of bankruptcy under a regime with successor liability, see supra note 62 and accompanying text—except that in bankruptcy, future claimants are residual claimants along with current creditors. Note that under state law, a going concern asset sale is typically “quick and dirty” in the sense that there is no mechanism for including future claims. See supra notes 32-36 and accompanying text. As in the nonbankruptcy case, piecemeal liquidation not only hurts future claimants, who are left with no recovery, but may also generate social costs with the destruction of going concern value.}
3. Consequences for Future Claimants

Now, where does this leave future claimants? They would share in a bankruptcy distribution only if current creditors and the acquire agreed to a clean going concern sale. Two conditions must obtain for this to occur. First, there must be some relatively significant chance that the acquirer would otherwise be subjected to successor liability following a quick and dirty going concern sale. Second, the value of the goodwill in the business must be high enough relative to the aggregate amount of future claims liability to entice current claimants to share going concern sale proceeds with future claimants, rather than liquidate.

In effect, future claimants would be included, and their nonbankruptcy rights compromised, only when those nonbankruptcy rights might be worth something. Only when their successor liability claims have some promise, and the business has sufficient goodwill to induce current creditors to share going concern value with future claimants, would future claimants be included in bankruptcy. Their inclusion forces them to take scaled down bankruptcy distributions worth less in the aggregate than if they had been free to pursue successor liability claims following bankruptcy.

If this were future claimants’ fate in every case, that would of

\(^{207}\) Again, we assume no transaction costs for now.

\(^{208}\) That is, where \(D_c > D_{qd}\). This holds when \(P_{sl} > R_c\). See supra note 199 and accompanying text.

\(^{209}\) That is, where \(D_c > D_{liq}\), which will hold when \(GW/FC > LV/CC\). Cf. supra text accompanying note 202.
course be unobjectionable. *Every* creditor’s claim is scaled down in bankruptcy. However, this is the *best* that future claimants can do. And they will often do worse. Future claimants will be excluded when that is cheaper for the other parties—that is, when future claimants’ nonbankruptcy rights are marginal or worthless and their losses may be left with them following bankruptcy.\footnote{210}{When the overall probability of successor liability outside of bankruptcy is relatively remote, current creditors and the acquirer will agree to a quick and dirty sale. When the value of the goodwill is low compared to the aggregate amount of future claims, current creditors will opt for piecemeal liquidation, and future claims will be excluded.}

Some advocates for the flexible approach overlook this potential for opportunism in external reorganization.\footnote{211}{Professor Davis has noted the perilous consequences for future claimants excluded from external reorganization. \textit{See} Davis, \textit{supra} note 115, at 367 (“It is in a sale, as opposed to a reorganization, that future claims are in the greatest danger of losing their fair share.”). He also notes the strategic incentives of current creditors to exclude future claims. \textit{See id.} However, this predicament does not disturb him as much as it does me. He seems content to let future claimants take their chances under state law successor liability rules. \textit{See id.} at 371-72. I critique his approach \textit{infra} Part IV.D.5.}
The NBC proposal fails even to explain its flexible approach,\footnote{212}{\textit{See supra} note 135. \textit{See also} Kathryn R. Heidt, \textit{Comment, Future Claims in Bankruptcy: The NBC Amendments Do Not Go Far Enough}, 69 AM. BANKR. L.J. 515, 519 (1995) [hereinafter Heidt, \textit{The NBC Amendments}] (criticizing flexible approach advocated in NBC \textit{FINAL REPORT}, which “leaves too much control over the treatment of future claims in the hands of the plan proponent.”).}

The NBC proposal—while noting the desirability of treating all claimants equally whether reorganization is accomplished internally or externally by way of sale\footnote{213}{\textit{See NBRC REPORT, supra} note 117, at 348-50.}—fails to account for the possibility of a quick and dirty sale. Under the proposal, an acquirer qualifies for formal insulation from successor liability only if sufficient protections are provided for future claimants in the

\textit{infra} Part IV.D.5.
bankruptcy proceeding.\textsuperscript{214} So far, so good. However, the proposal too optimistically finds this requirement sufficient to preclude the parties from “act[ing] strategically to disadvantage one class of claimants.”\textsuperscript{215} It fails to consider that when the parties are comfortable that successor liability risk is low, they will not \textit{need} a bankruptcy injunction to cut off the rights of future claimants. As in the nonbankruptcy context, the sale itself and subsequent distribution to current creditors will suffice.

The problem with a flexible approach, then, is that it enables exploitation of future claimants. Preserving future claimants’ nonbankruptcy rights while excluding them from the bankruptcy distribution is an empty promise. The strategic behavior of the other parties will always leave future claimants in the worst possible position. As in the nonbankruptcy context, residual claimants—here, current creditors—will contrive to maximize the losses left with future claimants.\textsuperscript{216}

\textsuperscript{214} The Proposal would prevent a debtor or trustee from selling off the major assets of the business and cutting off mass future claimants’ access unless the debtor satisfied the requirements for treating mass future claims. Without the appointment of a mass future claims representative, for example, the successor would not be protected from liability for mass future claims.

\textit{Id.} at 349.

\textsuperscript{215} \textit{Id.}

\textsuperscript{216} This replicates in bankruptcy the cost externalization problem meant to be addressed by successor liability under state law. \textit{See supra} Part II.C.1. Under a flexible approach, a solvent debtor—or a debtor solvent as long as future claims liability is not considered—could enter Chapter 11 and sell the business, much as it would under state law. Proceeds of the sale could be distributed to current creditors and shareholders, leaving future claimants to pursue the acquirer. To the extent that courts might be willing to issue free and clear sale orders even when future claims are excluded, \textit{see infra} note 243, the cost externalization would be even worse than under state law.

In addition to protecting future claimants from the liability-minimizing strategies of
4. A Note on Transaction Costs

The discussion thus far has assumed zero transaction costs in addressing future claims in external reorganization. When transaction costs are considered, a flexible approach appears even more attractive for current creditors and even less favorable to future claimants. Absent new approaches to the handling of future claims in bankruptcy, a clean sale will in most cases generate higher transaction costs in dealing with future claims than a quick and dirty sale.217

The quick and dirty sale does not eliminate all transaction costs associated with resolving future claims. The acquirer will have to pay litigation and settlement costs as future claimants appear to sue for successor liability. As with the direct costs of the future liability, the acquirer will discount its purchase price to account for the transaction costs. Current creditors’ distributions will be correspondingly reduced.

In general, however, including future claims in a clean sale will probably be more expensive in transaction cost terms. With the quick and dirty sale, given that successor liability is the minority rule, we can assume that on

other parties, mandatory inclusion of future claims puts a premium on the debtor’s preservation of its liability insurance to the extent it has any. Insurance may provide a relatively low cost device to insure a source of compensation to future claimants. By contrast, under a flexible approach, because losses may still be left with the victims, debtors and acquirers have imperfect incentives to maintain insurance, even though the debtor’s existing policy may be available. See Paris Mfg. Corp. v. Ace Hardware Corp. (In re Paris Indus. Corp.), 132 B.R. 504 (D. Maine 1991), discussed infra note 260.

217 And the piecemeal liquidation of course incurs no future claims related transaction costs. This assumes future claimants’ exclusion from the liquidation distribution. See supra note 201 and accompanying text.
average, fewer than half—and probably far fewer than half—of the future claims in a given case will ever have to be dealt with by the acquirer. The sale wipes out most of the future claims liability and associated transaction costs. In addition, the transaction costs of the piecemeal successor liability litigation are paid over time, as each future claim appears. By contrast, much of the administrative cost of addressing future claims in the clean sale must be paid up front. Absent significant refinements of or improvements on the traditional model, the clean sale will ordinarily be more expensive in transaction cost terms.

Incorporating transaction costs into our previous analysis, then, suggests that current creditors will rarely prefer a clean sale if given the choice,\(^{218}\) and future claimants’ prospects for recovery under a flexible approach will be even more grim than previously discussed. With flexibility, current creditors stand to maximize their own recoveries both by appropriating future claimants’ distributions and by garnering significant transaction cost savings as well.

While transaction costs will pose a formidable obstacle to inclusion

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\(^{218}\) Future claims will be included only when \(P_{sl} > R_c\), cf. supra note 208 and accompanying text, and \(GW/FC > LV/CC\). Cf. supra note 209 and accompanying text.

In order to discourage current creditors from the quick and dirty sale, the successor liability discount—which would include not only the direct costs of successor liability, but also the transaction costs of successor liability litigation—would have to be so high that the transaction costs of the clean sale—that is, the largely up-front costs of the traditional approach or some other structure to handle future claims—would be cheaper by comparison. In order to discourage piecemeal liquidation, the goodwill of the business relative to the aggregate amount of future claims liability would have to be significantly greater than the scrap value of the business relative to the aggregate amount of current claims. The goodwill of the business would have to be large enough to support both scaled down payments to future claimants and the transaction costs of including them. Otherwise, current creditors will push to liquidate.
of future claims in many cases, a flexible approach provides too easy a way out. It enables opportunism in the name of transaction cost savings. Moreover, plan proponents’ discretion to exclude future claims is unlimited. There is no guaranty under a flexible approach that future claims will be included even in large cases that might be able to support the costs of their inclusion. 219 And crafting workable limits on this discretion would likely be problematic. 220

The solution must lie in developing more economical approaches to treating future claims, 221 not in leaving to other parties the discretion to compromise future claimants’ interests in the name of transaction cost savings. If transaction cost considerations may justify exclusion of future claims, then why not exclude other creditors on that basis as well? 222 A flexible approach

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219 For example, as a purely legal matter, mass tort debtors like Johns-Manville and A. H. Robins could probably have sold their businesses out from under their future tort liabilities. They could have sold out, distributed the proceeds to current creditors and shareholders, and then liquidated, instead of reorganizing and addressing future claims. Given the state of successor liability rules and the transaction costs of the traditional model for including future claims, shareholder returns would have improved dramatically with a quick and dirty sale. Liability avoidance on such a massive scale, however, would have generated public outrage and probably specific legislative sanction. See LoPucki, The Death of Liability, supra note 42, at 51-54 (discussing cultural and political constraints on large-scale liability avoidance, noting in short that “all hell would break loose.”). That smaller cases fly below the public radar hardly suggests that liability avoidance on a smaller scale should be acceptable.

220 Cf. Keating, supra note 96 at 1099-1100 (noting difficulty of using relative magnitude of future claims liability to determine whether to include future claims).

221 I suggest possible approaches infra Part VI. The best solution may not be a corporate or bankruptcy or tort law fix. First-party insurance or administrative compensation schemes, for example, offer plausible alternatives. See generally Kenneth S. Abraham, Individual Action and Collective Responsibility: The Dilemma of Mass Tort Reform, 73 VA. L. REV. 845 (1987) (advocating expanded first-party insurance to compensate mass tort victims); Jennifer H. Arlen, Compensation Systems and Efficient Deterrence, 52 Md. L. REV. 1093, 1116 (1993) (comparing administrative compensation scheme with first-party insurance in mass tort context).

222 No one ever suggested in Texaco’s bankruptcy that Pennzoil should be excluded because of the transaction costs associated with liquidating that claim. I am being flip, of course. Addressing that claim was the sole purpose for the bankruptcy. See generally Robert H. Mnookin and Robert B. Wilson, Rational Bargaining and Market Efficiency: Understanding
fails to take future claims seriously, but is instead a prescription for exploiting unrepresented parties. Inclusion of future claims must not be optional on the part of the debtor, current creditors or the acquirer of the business, but must be made mandatory in external reorganization.  

5. Equal Treatment of Future Claims

Related to the mandatory inclusion of future claims is the requirement of equal treatment with other general creditors. Equal treatment of creditors similarly situated is a central bankruptcy policy. In external

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223 As an equal treatment rationale would suggest, this mandate should also apply to piecemeal liquidation in Chapter 7. Cf. NBRC Report, supra note 117, at 321 (“[M]ass future claimants of a debtor liquidating in Chapter 7 . . . should be entitled to equal priority with present claimants.”). Admittedly, the relatively steep transaction costs of mandating inclusion of future claims upon piecemeal liquidation may present the greatest challenge to the conceptual clarity herein proposed. However, forcing current claimants to share with future claimants regardless of the form of asset disposition may be necessary to eliminate any strategic incentive on the part of current claimants to push for piecemeal liquidation when a going concern might survive. Policing of this mandate in Chapter 7 may be problematic, however, as there will ordinarily be no going concern acquirer or other party with any stake in assuring that future claimants are provided for in the Chapter 7 distribution.

224 A rule of equal treatment, of course, does not necessarily answer the detailed questions concerning what exactly counts as equal. Cf. George Orwell, Animal Farm 123 (Signet 1946) (“All animals are equal. But some animals are more equal than others.”). For example, a twenty percent payout to current creditors upon conclusion of the case may not necessarily require an immediate payout of the same pro rata amounts on behalf of future claims. Given that future claims by definition will not mature until some time after the business is sold and the case concluded—that is, future claimants have yet to suffer the harm demanding compensation—their pro rata payout should be discounted to present value.


On the other hand, equal treatment has also been described as a “weak” bankruptcy norm. See Carlson, supra note 31, at 147 n. 116 (arguing that in absence of competing policy consideration, foreclosure of future products liability claims is justified by “weak bankruptcy norm in favor of equality.”). See also Roe, Mass Tort, supra note 2, at 855 (concluding that
reorganization, all general unsecured creditors should share available sale
proceeds pro rata. Future claimants and other tort creditors should therefore be
treated on a par with other unsecured creditors.\textsuperscript{226}

One might oppose this requirement on the ground that it
overcompensates future claimants, giving them rights in bankruptcy that they do
not enjoy outside of bankruptcy. Professor Davis argues that future claimants’
prospects of recovery outside of bankruptcy are so dim, given the vagaries of
successor liability law and the possibility of the debtor’s piecemeal liquidation,
that an equal treatment rule would “overvalue” future claims. Outside of
bankruptcy, future claimants may be vulnerable to dissolution strategies to which
present claimants would not. “If these future claims were to have a right to
participate equally with present claims, this would amount to a substantive right

\textsuperscript{226} This distributional prescription follows naturally from a rule of mandatory inclusion of
future claims. When the business is sold for cash, there is no reorganization-related
justification for disparate treatment among groups of unsecured creditors. \textit{Cf.} In re U.S. Truck
Co., 800 F.2d 581 (6th Cir. 1986) (requiring some functional distinction among creditors in
order to justify separate classification in internal reorganization plan).

This fairness-based equal treatment approach may be said to go farther than other
proposals advocating mandatory inclusion of future claims insofar as it advances a
distributional prescription across all unsecured creditor groups. Others either make no
distributional claim—relying on other rationales for mandatory inclusion—or limit their
distributional prescriptions to equity among tort claims, without focusing specifically on the
external reorganization context. \textit{See supra} notes 127-129 and accompanying text. However, I
suspect that in the external reorganization context, my distributional prescription would be
uncontroversial to advocates for mandatory inclusion.
to *improve* their state-law position.”

Assuming the state law outcome is the proper benchmark for comparison, and taking Professor Davis’ argument on its own terms, it proves too much. The rule of equal treatment always improves the position of some creditors as compared to their would-be positions under state law. In the race of diligence outside of bankruptcy, certain creditors are always advantaged over others. When the equal treatment regime is triggered by the bankruptcy filing, creditors who would otherwise win the race to seize the debtor’s assets always

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227 See Davis, supra note 115, at 366. Professor Davis argues both that future claims need not be included in the bankruptcy process, and that if included, they need not be treated equally with current creditors, but only “fairly, in a way that is at least commensurate with their prospects under state law.” *Id.* at 366-67.

228 Traditionally, nonbankruptcy outcomes have been relied upon as the appropriate baseline against which to track bankruptcy outcomes. See Butner v. United States, 440 U.S. 48 (1979):

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving “a windfall merely by reason of the happenstance of bankruptcy.”


However, that traditional baseline has recently been called into question. See LoPucki, *The Unsecured Creditor’s Bargain*, supra note 23, at 1945-47. Professor LoPucki asserts that as a practical matter, most unsecured creditors have no substantive state law rights against the debtor’s assets. For their repayment, they rely instead on procedural rights to extract payment from the debtor’s encumbered cash flow, a practice he calls “cash-flow surfing.” Because unsecured creditors have no substantive rights of any significance, attempting to replicate such rights in bankruptcy is futile. *Id.*

229 See *supra* note 95 and accompanying text.
lose out, and creditors who would lose under state law benefit. That future claimants are vulnerable outside of bankruptcy does not distinguish them from many current creditors.

For example, small trade creditors are typically disadvantaged compared to institutional lenders. Institutional lenders include reporting requirements and covenant defaults in their lending documents. Their monitoring of the debtor’s financial and operational performance will be much more active than that of trade creditors. They will typically realize higher percentage recoveries under state law collection rules than small trade creditors. No one suggests that this circumstance justifies systematic favoritism of institutional lenders’ unsecured claims in bankruptcy, or the systematic disfavoring of small trade creditors.

Are future claims different in kind from current claims, such that unequal treatment may be justified? After all, future claimants typically have no enforcement rights against the debtor outside of bankruptcy. Because future

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230 Moreover, a fundamental purpose of the preference rules and the automatic stay is to discourage this destructive race to dismember the debtor. “If preferences are tolerated, a firm may be dismembered before bankruptcy and have no chance to survive as a going concern, even though everyone would have been better off if it had. Preference law exists because it deters gun-jumping.” DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 425 (2d ed. 1990).

231 See Saul Levmore, Monitors and Freeriders in Commercial and Corporate Settings, 92 YALE L.J. 49, 53 & 72 (noting relatively superior monitoring abilities of institutional creditors and bondholder trustees, and relatively inferior monitoring abilities of employees and occasional suppliers).

232 “[T]he owners may choose to dismantle the company, selling it off piecemeal. In these instances, present claimants will be able to employ a number of devices, such as attachment, execution, fraudulent conveyance law, injunction or receivership, to protect their prospective recovery. Future claims, in contrast, would have no say in the matter. If a claim cannot yet be asserted, the claimant is powerless to affect the legitimate affairs of its future obligor.” Davis,
claimants could not even get to the starting line to compete in the race of diligence, this disability might justify poorer treatment in bankruptcy. However, this bright line between current and future claimants blurs upon closer inspection. Future claimants do have rights under state law. In some states, a cause of action may accrue simply on the basis of exposure to a hazard, even before injuries have developed. Future claimants, as contingent creditors, may also fall within the protections of the fraudulent transfer laws. Some states require that provision be made for future claimants upon a corporation’s dissolution. And finally, the nonbankruptcy analog brings us full circle, since successor liability may be available outside of bankruptcy to compensate future claimants despite their ostensible disability in the race of diligence.

More generally, rather than focusing on ways that future claimants may be exploited under state law to decide their proper bankruptcy treatment, we need only recognize their status as creditors in order to conclude they deserve

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supra note 115, at 365.

233 For example, in In re UNR Indus., Inc., 725 F.2d 1111 (1983), Judge Posner noted that medical evidence exists that shows microscopic injury to the body as soon as asbestos fibers lodge in the lungs, and that “states differ on whether a cause of action in an asbestosis case accrues upon inhalation or not until there is palpable disease or the disease is discovered.” Id. at 1119 (citations omitted). See also Roe, Mass Tort, supra note 2, at 896 n.153 (suggesting that in some states, a cause of action accrues upon mere exposure to a hazard, even without manifestation of injury).

234 See American Sur. Co. v. Marotta, 287 U.S. 513 (1933) (noting common law rule that creditor with only contingent claim is nonetheless protected against fraudulent conveyance); U.F.T.A. § 1(3) (defining “claim” to include contingent and unmatured rights to payment).

235 See supra note 32.

236 Moreover, successor liability may sometimes prefer future claims over current creditors in the state law race. However, that does not suggest future claims should do better in bankruptcy than other creditors. Successor liability outside of bankruptcy attempts to solve a problem
equal treatment. While discounting their claims to present value seems appropriate, it seems inappropriate to discount them—and only them—based on creditor vulnerabilities under state law that bankruptcy is specifically designed to ameliorate.

whose answer in bankruptcy is absolute priority and equal treatment. See infra Part V.B.2.
V. SUCCESSOR LIABILITY AND EXTERNAL REORGANIZATION

Provided that future claimants share ratably in the bankruptcy sale proceeds, then as with other creditors, future claimants’ rights in external reorganization should be exclusive. Their successor liability rights must be extinguished. Bankruptcy courts have resorted to the channeling injunction to permanently enjoin successor liability claims, while channeling future claims to a trust or other payment mechanism established to satisfy such claims as they mature.237

Bankruptcy theorists support this resolution.238 However, its legal basis is unclear. The channeling injunction is not obviously authorized by the Code in the external reorganization context, and prominent courts have questioned the permissibility of bankruptcy court injunctions against successor liability actions.

This Part argues that authority for enjoining successor liability claims in external reorganization is well within the general equitable powers of the bankruptcy court. This Part further attempts to explain the skepticism expressed by certain courts toward the channeling injunction. I suggest that this

237 This term was coined in the mass tort bankruptcies. Channeling injunctions have been used both in internal reorganization in connection with the Chapter 11 discharge, and in external reorganization, where no discharge applies. See supra note 146 and accompanying text.

238 See Baird, The Uneasy Case, supra note 5, at 145-46 (“A sale of assets to a third party must be free of all claims against it. Those who have claims against the firm must satisfy themselves out of the proceeds of the sale. If they are able to pursue the assets at a later time, the price that can be realized from the sale will be depressed.”); Carlson, supra note 31, at 145; Heidt, Changing Paradigm, supra note 11, at 1084; Jackson, Logic and Limits, supra note 93, at 53 (“The preferable solution . . . is to include the nonmanifested tort victims in the bankruptcy process as holders of claims, so they get to share in the assets, but then to sell the assets free of all such claims.”); Jackson, Translating Assets and Liabilities, supra note 117, at 96-97.
skepticism may stem from a misconception concerning the proper purpose for successor liability. Cost internalization is the right rationale. Under that approach—bankruptcy considerations aside—successor liability is unnecessary following an external reorganization that accounts for future claims.

A. Enjoining Successor Liability in External Reorganization

A going concern sale in bankruptcy will typically occur in Chapter 11.239 It is typically effected either pursuant to the debtor’s general authority to deal with estate property in bankruptcy,240 or through a liquidating plan.241 Section 363(f) is often relied upon for authority to sell the assets “free and clear” of all liens and claims,242 including successor liability claims.243

239 The sale could theoretically occur in Chapter 7. However, as Professor Baird has noted, going concern sales in Chapter 7 are rare. “As a practical matter, . . . we never see ‘going-concern’ liquidations in Chapter 7. The managers of a corporation prefer the control and the presumption of continued operation that exists in Chapter 11. They will not file a Chapter 7 petition as long as they harbor any hope for the firm.” BAIRD, supra note 126, at 16.

240 “The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1) (1994). While § 363 refers to the trustee’s authority, under § 1107(a), the debtor in possession is authorized to run the business in Chapter 11, with the rights and powers of a trustee. Id. § 1107(a).

241 A liquidating plan calls for the sale of all or substantially all assets of the estate and payment of creditor claims from the sale proceeds. Such a plan is authorized under section 1123(b)(4). See id., § 1123(b)(4). See also infra note 246 and accompanying text.

242 Section 363(f) provides that the trustee may sell estate property free and clear of any interest in such property of any entity other than the estate only if:

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or
However, whether a successor liability claim qualifies as an “interest in property” referred to in the statute is unclear.\textsuperscript{244} The Chapter 11 discharge is also

\begin{enumerate}
\item[(5)] such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
\end{enumerate}


\textsuperscript{243} Sales free and clear of successor liability claims have been authorized by bankruptcy courts under § 363(f) even though future claims were ignored. See, e.g., Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714 (1st Cir. 1994) (overruling bankruptcy court holding that § 363(f) authorizes injunction against successor liability claims where tort victims never received notice of bankruptcy); American Living Sys. v. Bonapfel (In re All American of Ashburn, Inc.), 56 B.R. 186, 189 (Bankr. N.D. Ga.), aff’d sub nom. Griffin v. Bonapfel, 805 F.2d 1515 (11th Cir. 1986) (finding that sale of assets “free and clear of all claims pursuant to 11 U.S.C. § 363(f)” precludes successor products liability claim against asset purchaser (emphasis supplied)). See also In re Leckie Smokeless Coal Co., 99 F.3d 573 (4\textsuperscript{th} Cir. 1996) (holding that “successor in interest” liability for benefit plan premium under Coal Act constitutes “interest in property,” such that § 363(f) authorizes bankruptcy sale free and clear of such liability); WBQ Partnership v. Commonwealth of Virginia Dep’t of Med. Assistance Servs. (In re WBQ Partnership), 189 B.R. 97 (Bankr. E.D. Va. 1995) (finding that § 363(f) authorizes bankruptcy sale of substantially all debtor’s assets, free and clear of state agency’s state law right to proceed against asset purchaser for depreciation recapture relating to Medicaid cost reimbursements previously received by debtor); Lee R. Bogdanoff, The Purchase and Sale of Assets in Reorganization Cases—Of Interest and Principal, of Principles and Interests, 47 BUS. LAW. 1369, 1419 (1992) (proposing that “greater” power to sell assets free and clear of liens under § 363(f) should include “lesser” power to sell assets free and clear of successor liability “interests.”).

\textsuperscript{244} See, e.g., Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.), 184 B.R. 910 (Bankr. W.D. Tx. 1995) (holding that section 363(f) sale may only extinguish in rem interests which have attached to property, but not in personam liabilities such as “trailing” tort liability); Zerand-Bernal Group v. Cox, 23 F.3d 159, 163 (7th Cir. 1994) (Posner, C.J.) (finding that sale pursuant to § 363(f) may cleanse assets of liens and other encumbrances, but not successor product liability claims); Wilkerson v. C.O. Porter Machinery Co., 567 A.2d 598 (N.J. Super. 1989) (finding that § 363(f) does not address successor liability claims).

See also Volvo White Truck Corporation v. Chambersburg Beverage, Inc. (In re White Motor Credit Corp.), 75 B.R. 944, 948 (Bankr. N.D. Ohio 1987) (holding that section 363(f) only authorizes sales free and clear of specific interests in property being sold, but is inapplicable to sales free and clear of tort claims or other general unsecured claims, as such claimants have no specific interest in property; but that authority for sale free and clear of successor liability may be found in § 105(a), and is coextensive with power to discharge claims under plan of reorganization); Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714 (1st Cir. 1994) (explicitly reserving question of whether section 363(f) enables extinguishment of state law successor “product-line” liability claims, while holding that because of inadequate notice to such claimants, their claims survived against both debtor and asset purchaser).

The NBC and NBRC each recommend amendment of § 363 in order to make clear that
unavailable in this context to foreclose the rights of future claimants. Chapter 11 discharge is reserved for debtors reorganizing internally.\textsuperscript{245} The liquidating debtor, by contrast, is left with no business to run and therefore does not need a discharge.\textsuperscript{246}

\begin{center}
\begin{footnotesize}
asset sales under that provision would be free and clear of successor liability claims, provided that future claims were included in the bankruptcy proceeding and accorded proper treatment. See \textit{NBC Final Report, supra} note 117, at 287; \textit{NBRC Report, supra} note 117, at 347-50. One problem with this approach is that at the time of any asset sale under \textsection{} 363, the specific bankruptcy treatment of future claims will probably not have been decided yet—and almost certainly not documented in any binding fashion. Therefore, any free and clear sale order would necessarily be conditional, and would ultimately need to be supplemented by a permanent channeling injunction at the end of the case. Or if no free and clear sale order could issue until treatment of future claims had been determined, see \textit{NBRC Report, supra} note 117, at 350 (“[E]ntering a free and clear order would entail a finding that the debtor satisfied the requisite standards for treating mass future claims.”), that would ordinarily be at a point late in the case, such that a permanent injunction could issue with or shortly after issuance of the free and clear sale order. These proposals, then, would not in practice differ much from the channeling injunction approach described herein.\textsuperscript{.}

\textsuperscript{245} With internal reorganization, the Chapter 11 discharge is probably effective to preclude successor liability claims, assuming future claims are dealt with in the case. See \textit{Volvo White Truck, 75 B.R.} at 950.

The liability which state law imposes through successor liability is that of the manufacturer. The federal purpose of final resolution and discharge of corporate debt is clearly compromised by imposing successor liability on purchasers of assets when the underlying liability has been discharged under a plan of reorganization. Moreover, successor liability is precluded by \textsection{} 1141(c) which specifically frees debtors’ property from creditors’ claims. Successor liability in these circumstances has, therefore, been pre-empted by the Bankruptcy Code.

\textit{Id.} The reorganization plan at issue had made provision for future claims. See \textit{id.} at 947; Conway \textit{v. White Trucks, 885 F.2d} 90, 91 (3d Cir. 1989) (describing provision for future claims). Ironically, however, the claim at issue was not a future claim but a claim involving a preconfirmation accident. The tort victim filed a proof of claim but also attempted to sue Volvo as a successor. See \textit{Volvo White Truck, 75 B.R.} at 947.

\textsuperscript{246} \textsection{} 11 U.S.C. \textsection{} 1141(c), (d)(3). \textsection{} 1141(d)(3) provides that:

\begin{itemize}
  \item[(A)] the plan provides for the liquidation of all or substantially all of the property of the estate;
  \item[(B)] the debtor does not engage in business after consummation of the plan; and
  \item[(C)] the debtor would be denied a discharge under \textsection{} 727(a) of this title if the case were a case under chapter 7 of this title.
\end{itemize}
Despite the lack of clear statutory authority, a channeling injunction may be justified as an exercise of the bankruptcy court’s general equitable powers under Section 105(a). The channeling injunction is the functional equivalent in external reorganization to the Chapter 11 discharge in internal reorganization. Though the liquidating debtor is not entitled to a discharge and does not need one, the going concern that survives external reorganization does require insulation from the debtor’s preconfirmation obligations. An understanding of the role of Chapter 11 discharge will make the point.

Id.

A plan would probably be considered a liquidating plan if it called for sale of all or substantially all of the debtor’s assets—whether sold as a going concern or piecemeal. Section 1141(d)(3) is a “corollary provision” to § 727(a), see 8 COLLIER ON BANKRUPTCY § 1141.05[3], at 1141-19 (15th ed. rev’d 1997), which precludes any entity liquidating in Chapter 7 from receiving a Chapter 7 discharge. 11 U.S.C. § 727(a)(1) (1994). This Chapter 7 prohibition does not depend on whether the Chapter 7 trustee sells the assets piecemeal or as a going concern. Therefore, it would seem reasonable to expect that the corollary prohibition of § 1141(d)(3) would result in a similar outcome—that is, denial of a discharge to a Chapter 11 debtor that is left with no assets or business to run. See also Michigan Employment Sec’y Comm’n v. Wolverine Radio Co., Inc. (In re Wolverine Radio Co.), 930 F.2d 1132, 1147 n.21 (“A corporation in Chapter 11 that does not continue in business after plan confirmation does not receive a discharge.”).

247 “The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a) (1994). The purpose is “to assure the bankruptcy courts power to take whatever action is appropriate or necessary in aid of the exercise of their jurisdiction.” 2 COLLIER ON BANKRUPTCY, supra note 246, ¶ 105.01, at 105-5. This power is not limitless. Its exercise must be consistent with the provisions of the Code. It “does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity.” U.S. v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986)(citation omitted). See generally 2 COLLIER ON BANKRUPTCY, supra note 246, ¶ 105.01 (describing contours of bankruptcy court’s power under § 105(a)).

248 Concerning the parallels between internal and external reorganization, see supra note 110-111 and accompanying text.
1. Chapter 11 Discharge and the Channeling Injunction

Unlike an individual debtor in consumer bankruptcy, a corporation reorganizing in Chapter 11 does not get a fresh start. It does not emerge from bankruptcy with a clean slate. Its slate will only be as clean as creditors are willing to allow. Moreover, creditors negotiate not only with the debtor concerning treatment of their respective claims in reorganization. As important, they negotiate with each other, apportioning what all understand is a fixed pool of value. The process is multilateral, with settlement among creditors as a critical feature. What any creditor receives depends to a great extent on what other creditors are willing to give up.

Because of this creditor interdependence, Chapter 11 discharge functions not only to shield the emerging debtor from its creditors’ prebankruptcy claims, but also to protect creditors from each other. The discharge insulates the postconfirmation going concern from preconfirmation claims, thereby preserving for creditors the value of their respective postconfirmation stakes in the reorganized debtor that were negotiated as part of the plan. The discharge operates to enforce the finality of the collective settlement. It limits each creditor to its agreed share of the common pool.

The channeling injunction performs this same function in external

\[249\] See J ACKSON, LOGIC AND LIMITS, supra note 93, at 191 ("Corporations that reorganize under chapter 11 do, to be sure, receive a discharge... However, it is wrong to conclude that the reasons for such discharge are derived from a financial fresh-start policy.").

\[250\] See BAIRD, supra note 239, at 69 ("The discharge... is necessary to rearrange the firm’s capital structure. One cannot recapitalize a firm unless all existing rights against it are canceled and new ones are issued in their stead.").
reorganization. Whether the going concern is ultimately owned by creditors or third parties or some combination, all involved must be assured of the finality of any collective settlement. Where creditors as a group opt to cash out by selling the going concern to a third party, the future claims channeling injunction serves that purpose.\textsuperscript{251} It assures each creditor—including each future claimant—that no other creditor may appropriate more than its pro rata share of the common pool.

2. \textit{The Channeling Injunction and Bankruptcy Norms}

Gaps in the collective settlement frustrate the pursuit of bankruptcy goals. Survival of the going concern, maximizing of creditor recoveries, and equal treatment of creditors all depend on a bankruptcy settlement that is both comprehensive and final.\textsuperscript{252} Absent a channeling injunction, some future claimants may stand to recover in full from the acquirer.

\textsuperscript{251} Cf. Baird & Jackson, \textit{supra} note 93, at 110 n.45. Professors Baird and Jackson describe the role of the corporate discharge in Chapter 11 as a device to effect parity among the various asset deployment choices that are available to the debtor’s investors. Internal reorganization is in effect a going concern “sale” in which creditors sell the firm to themselves, foregoing their prebankruptcy claims against the debtor’s assets in exchange for their agreed plan consideration. The discharge enables this “sale” of assets free of prebankruptcy claims, in the same way that sale to a third party and dissolution would effect this outcome outside of bankruptcy. Without the discharge in Chapter 11 reorganization, the debtor’s investors could not make an unbiased decision concerning asset deployment, since only disposition to a third party would be effective to free the assets from their presale liabilities. \textit{Id.}

Successor liability, ironically, raises the converse problem. Unlike most corporate liabilities, successor liability claims \textit{may} survive the sale and dissolution outside of bankruptcy. But they probably do not survive the Chapter 11 discharge if the debtor reorganizes internally and includes future claims in the proceeding. \textit{See supra} note 245. Absent the channeling injunction, successor liability claims would also survive the going concern sale in Chapter 11, that is, the “external reorganization.” Therefore, the channeling injunction is necessary to equalize treatment of future claims as between internal and external reorganization.

\textsuperscript{252} Similar concerns require mandatory inclusion of future claims in bankruptcy. \textit{See supra} notes 122-126 and accompanying text.
However, such recoveries come at the expense of the common pool, as a result of the acquirer’s successor liability discount.\(^{253}\) This dampening of bids for the business frustrates bankruptcy’s attempt to maximize recoveries for creditors as a group. Sale of the going concern may depend on bankruptcy’s ability to include future claims and foreclose attendant successor liability rights. Disability in this regard may inhibit any sale and imperil the survival of the business—the very same problem created by successor liability outside of bankruptcy.\(^{254}\)

Survival of successor liability claims also creates equal treatment problems. The successor liability discount may draw 100-cent dollars from the common pool to pay future claims liability not satisfied in bankruptcy. The future claimant stands to have her claim paid in full by the successor following bankruptcy, while “like” current creditors receive only partial satisfaction from a diminished pool of sale proceeds.\(^{255}\) The future claimant is thereby accorded priority treatment, which is inconsistent with the equal treatment norm.\(^{256}\)

\(^{253}\) See discussion supra p. 31.

\(^{254}\) See supra note 62 and accompanying text. Professor Carlson discusses this problem of effective foreclosure rules, noting that the rules must provide for the termination of enough pre-existing interests in the property subject to sale, such that a prospective purchaser is given something worth buying. See Carlson, supra note 31, at 121.

\(^{255}\) “The successor liability specter would chill and deleteriously affect sales of corporate assets, forcing debtors to accept less on sales to compensate for this potential liability. This negative effect on sales would only benefit product liability claimants, thereby subverting specific statutory priorities established by the Bankruptcy Code.” Volvo White Truck Corp. v. Chambersburg Beverage, Inc. (In re White Motor Credit Corp.), 75 B.R. 944, 950 (Bankr. N.D. Ohio 1987).

\(^{256}\) See Heidt, The NBC Amendments, supra note 212, at 520. Moreover, the future tort victim is preferred over the current tort victim, though the same debtor conduct is responsible for both injuries. “Only serendipity explains why one claimant is bound by the plan, while the other is
The channeling injunction assures that the proceeds from selling the business will not be diminished by the threat of postbankruptcy successor liability suits, and that no future claimant will be able to obtain more than her due at the expense of other creditors.

Moreover, any external reorganization could be structured as an internal reorganization in order to assure a Chapter 11 discharge. The third-party acquirer, instead of purchasing the debtor’s business outright, could contribute the purchase price to the internally reorganized entity in exchange for its new common stock. The discharge would hold future claimants to the terms of the collective settlement. It would foreclose the rights of future claimants against the reorganized entity, as long as future claims were provided for in the plan.\footnote{Insulation of the going concern from the claims of prepetition creditors, however, should not depend on the form of the reorganization or the structuring of the sale transaction.}{\textsuperscript{257}}

\footnote{See supra note 245.}

\footnote{257} See supra note 245.

\footnote{258}{The proposal of the National Bankruptcy Review Commission makes the same point. See NBRC REPORT, supra note 117, at 350.}

In fact, there may be good reason not to force a contrived internal reorganization on a third-party acquirer for the sole purpose of foreclosing future claims. Internal reorganization is ordinarily expensive. It typically requires either (i) formal valuation of both the going concern and any “tickets” issued to prebankruptcy creditors in consideration for their claims, see generally Clark, supra note 110, at 1252-54, or (ii) multilateral negotiation in order to avoid the cost and uncertainty of such formal valuations. See Roe, Successor Liability, supra note 36, at 1570 n.28 (“[T]he task of valuation is onerous, unpredictable, and ill-suited to judicial treatment that one might argue that the current framework for corporation reorganization in chapter 11 of the Bankruptcy Code was constructed largely to avoid the difficulties of judicial
Provided that the collective settlement in bankruptcy includes future claimants, then that settlement should foreclose their rights against the going concern. The channeling injunction does that. The court’s power to enjoin successor liability claims as part of an external reorganization should therefore be co-extensive with the scope of the discharge of claims in internal reorganization.259

valuation.”).

By contrast, the sale of the going concern to a third party generally avoids these valuation questions, as well as the costs of strategic behavior inherent in plan negotiation. The typical sale consideration will be cash or marketable securities, whose value is readily ascertainable. Once the business is sold, the question of its value is answered. The distribution will follow absolute priority, with little room to haggle over valuation. See Baird, The Uneasy Case, supra note 5, at 139 (noting that while outright sale in bankruptcy eliminates valuation and distribution issues, internal reorganization requires complex proceeding fraught with opportunities for strategic behavior by parties in interest).

Forcing the parties to cast their transaction as an internal reorganization might leave room for disgruntled parties to reopen issues—valuation, for example—that would be foreclosed in a straight sale via a liquidating plan. That would unnecessarily increase the costs of the transaction for all interested parties. It might force the acquirer, an outsider, to have to navigate through the internecine conflicts among prebankruptcy creditors and equityholders. In the worst case, it might saddle the acquirer with the burden of having to negotiate a capital structure with “lenders” not of her own choosing, when ex hypothesi she would have been willing to pay cash for the business.

259 See Volvo White Truck, 75 B.R. at 948 (holding that § 105(a) provides authority to sell assets free and clear of successor liability claims, and that such authority is coextensive with Chapter 11 discharge power).

This analysis is not affected by the existence of § 524(e), which states that the discharge “does not affect the liability of any other entity on, or the property of any other entity for, [the discharged] debt.” 11 U.S.C. § 524(e) (1994). As the text explains, the channeling injunction does not depend on the particular debtor’s eligibility for discharge. However, some courts have seized on this provision to suggest that successor liability cannot be affected by bankruptcy. See Zerand-Bernal Group v. Cox, 23 F.3d 159, 163 (7th Cir. 1994) (“[D]ischarge operates as an injunction, but only against the . . . debtor.”); Wilkerson v. C.O. Porter Machinery Co., 567 A.2d 598, 603 (N.J. Super. 1989).

Section 524(e) has been read to preclude release of third parties, such as the debtor’s co-obligors or guarantors, who have independent obligations to pay debts as to which the debtor enjoys a discharge. See, e.g., In re American Hardwoods, 885 F.2d 621 (9th Cir. 1993) (holding that confirmed plan could not insulate debtor’s nondebtor guarantors from liability through permanent injunction). However, where a nondebtor third party, which might otherwise be liable as the debtor’s co-obligor, contributes to the funding of the reorganization,
B. Judicial Hostility to the Bankruptcy Solution

The lack of explicit statutory authority for the channeling injunction, coupled with the fact that future claims are ordinarily ignored in external reorganization, has led some courts to issue broad pronouncements declaring bankruptcy’s inability to affect successor liability claims.

When future claimants are excluded from bankruptcy’s collective settlement, courts have almost uniformly—and quite correctly—held that the preceding bankruptcy could not affect their rights. Barring successor liability claims in that context would violate fundamental notions of due process, eliminating future claimants’ rights through legal proceedings of which they

courts have been willing to rely on their general equitable powers to insulate that contributing third party from postbankruptcy suit. See Menard-Sanford v. Mabey (In re A.H. Robins Co.), 880 F.2d 694 (4th Cir. 1989); In re Master Mortgage Investment Fund, Inc., 168 Bankr. 930 (W.D. Mo. 1994) (enumerating factors justifying injunction insulating nondebtor third party, including (i) nondebtor’s contribution of substantial assets to reorganization and (ii) fact that suit against contributing nondebtor would deplete estate assets because of an identity of interest between the debtor and the nondebtor third party), and cases cited therein. With external reorganization, of course, the acquirer funds the entire reorganization through its payment of the purchase price for the business. The threat of postbankruptcy successor liability diminishes that pool of estate assets.

See, e.g., Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714 (1st Cir. 1994); Zerand-Bernal Group v. Cox, 23 F.3d 159 (7th Cir. 1994); Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.), 184 B.R. 910 (Bankr. W.D. Tx. 1995). Cf. Paris Mfg. Corp. v. Ace Hardware Corp. (In re Paris Indus. Corp.), 132 B.R. 504 (D. Maine 1991). In Paris, the district court upheld the bankruptcy court’s injunction against interim claimants’ prosecution of their state court products liability suit despite the fact that no bankruptcy notice was given. The court reasoned that the claimants were not prejudiced by the lack of notice, since they were not challenging the adequacy of the sale proceeds, which were insufficient to pay any unsecured claims. Instead, the claimants complained that the trustee had canceled the debtor’s products liability insurance which would have covered their claims. Had they received notice of the sale, the claimants would have appeared before the court in order to persuade the trustee to maintain the insurance. See Paris, 132 B.R. at 509.

Another issue which has arisen in this maze is whether the bankruptcy court has jurisdiction to enjoin a successor liability suit after the bankruptcy case has been closed. Compare Zerand, 23 F.3d 159 (finding lack of jurisdiction) with Volvo White Truck, 75 B.R. at 947 (finding jurisdiction). That issue will not be addressed herein.
received no notice and in which they were unrepresented.\textsuperscript{261} By contrast, postbankruptcy successor liability enables tort victims to be compensated. As in the nonbankruptcy context, it prevents the firm from using a sale and liquidation to leave losses from product-related injuries with the future victims. The necessity for successor liability would not appear to be affected by the fact of a bankruptcy that failed to consider future claimants’ rights.\textsuperscript{262}

Unfortunately, that future claims are typically ignored in external reorganization has led some courts to conclude that future claims may never be affected in external reorganization. Under this view, external reorganization is ineffective to foreclose successor liability claims, even if provision were made for payment of future claims along with other claims against the debtor.

The case of \textit{Zerand-Bernal Group, Inc. v. Cox}\textsuperscript{263} provides an example.\textsuperscript{264} The bankruptcy court attempted to enjoin successor liability claims

\begin{itemize}
\item \textsuperscript{261} See Savage, 43 F.3d 714:
\begin{quote}
The Code “notice” requirements have even greater force in a case like the present, where the order approving the proposed sale authorized a transfer of substantially all chapter 11 estate assets—for present purposes, the functional equivalent of an order confirming a conventional chapter 11 reorganization plan. As such, the order confirming a chapter 11 liquidation sale warrants especial bankruptcy court scrutiny. \textit{Id.} at 720 n.9.
\end{quote}

\item \textsuperscript{262} Assuming the debtor is insolvent, successor liability in this context will prefer future claimants over current creditors, just as it does outside of bankruptcy. See discussion supra p. 38. However, this result is less objectionable than in the nonbankruptcy context, where current creditors and the acquirer have no ready means to effect an equal distribution that includes future claimants. By contrast, in the bankruptcy situation, the successor liability threat may be necessary to provide the proper inducement to current creditors and the acquirer to do just that—to include future claims. See discussion infra p. 130.

\item \textsuperscript{263} 23 F.3d 159 (7th Cir. 1994) (Posner, J.).

\item \textsuperscript{264} See also infra notes 275-280.
\end{itemize}
brought four years after a bankruptcy sale. Future claims had been ignored in the
bankruptcy at issue. The court of appeals held that the bankruptcy court lacked
jurisdiction to issue the injunction. It opined further that even if future claimants
had been provided for in the bankruptcy, their successor liability claims could
not have been enjoined.265 While noting the lack of statutory authority for such
an injunction, the court expressed skepticism that the threat of successor liability
would depress sale prices for assets in bankruptcy.266 To allow the court to
enjoin successor liability claims on that basis would justify

a blanket power to enjoin all future lawsuits against a buyer at a
bankruptcy sale in order to maximize the sale price: more, that the court
could in effect immunize such buyers from all state and federal laws that
might reduce the value of the assets bought from the bankrupt.267

This sort of unlimited power would provide “incentive to enter bankruptcy for
reasons that have nothing to do with the purposes of bankruptcy law.”268 The
court concluded that bankruptcy can never affect successor liability claims.269

Because future claims were excluded in Zerand, survival of

265 In contrast to this, Judge Posner has in other circumstances been more receptive to
bankruptcy treatment of future claims. See supra note 165.

266 See Zerand, 23 F.3d at 161 (7th Cir. 1994) (finding that successor liability suit several years
after bankruptcy distribution “cannot possibly” affect amount available for distribution to
creditors, since all of debtor’s property had already been distributed)

267 Id. at 163.

268 Id.

269 According to the court, no bankruptcy mechanism is necessary to foreclose future claimants’
successor liability claims, since inclusion of future claims in the bankruptcy would have
rendered successor liability unavailable as a matter of state law. “[T]he successorship doctrine
. . . is inapplicable if the plaintiff had a chance to obtain a legal remedy against the
predecessor, even so limited a remedy as that afforded by the filing of a claim in bankruptcy.”
Id. This assertion concerning state law outcomes may not be universally true. See infra note
274 and accompanying text.
successor liability was the right result. However, contrary to the court’s assertion, in the proper circumstances an injunction against successor liability is central to the purposes of bankruptcy law. Such an injunction would not purport to enjoin “all future lawsuits” against an acquirer, but only those of future claimants whose rights had been recognized in bankruptcy. It would not purport to bind creditors of the acquirer—aside from successor liability claimants—but only creditors of the debtor. As with the debtor’s other creditors, future claimants’ ratable share of the common pool should be their exclusive recovery. The court’s pronouncements tend to undercut bankruptcy goals.

How might we explain this hostility to the bankruptcy powers that may be necessary to afford relief in an appropriate case? While sympathy for future claimants may play some part, as courts search for rationales to afford them compensation, that fails to explain the categorical nature of the conclusion that bankruptcy may never affect successor liability claims. I suggest in addition that misperceptions concerning the purpose for successor liability may provide an answer.

As discussed earlier, in the courts the prevailing conceptual justification for successor liability focuses on the acquirer’s ex post loss spreading role. The acquirer, as the successor to the business, must also succeed to the manufacturer’s role in spreading among consumers the losses from product

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270 The court was correct in noting that the possibility of depressed asset sale bids could not justify “allow[ing] the parties to bankruptcy sales to extinguish the rights of third parties, here future tort claimants, without notice to them or (as notice might well be infeasible) any consideration of their interests.” *Id.*
defects. It does this through its pricing of the product.\textsuperscript{271}

Not only does this justification fail to withstand scrutiny,\textsuperscript{272} but this conception of successor liability has other pernicious consequences as well. In particular, it tends to obscure the fact that future claimants are first and foremost creditors of the manufacturer, not the acquirer. By contrast, a cost internalization approach to successor liability, a more persuasive rationale, makes clear that the primary target of liability is the manufacturer. Under that approach, costs are imposed on the acquirer in order indirectly to place the costs of accidents with—and enable future claimants’ recovery from—the manufacturer.\textsuperscript{273}

1. Loss Spreading and the Common Pool

If the point of successor liability were simply to substitute the acquirer for the manufacturer as a post hoc loss spreading device, there would be no conflict between the achievement of this end and the goals of bankruptcy. The acquirer is made liable, not to place costs on the manufacturer, but to spread losses from product-related injuries among consumers of the acquirer’s products. Under this view, the acquirer’s loss spreading activity is a phenomenon unrelated to the preceding bankruptcy of the manufacturer. Future claimants’ recoveries

\textsuperscript{271} See supra note 59 and accompanying text, and text accompanying supra note 67.

\textsuperscript{272} See supra Part II.C.1.

\textsuperscript{273} This passing of liability to the manufacturer occurs in the negotiation between manufacturer and acquirer over the purchase price for the business. See supra notes 73-75 and accompanying text.
from the acquirer and the acquirer’s passing of those costs onto its customers are simply postbankruptcy transactions having no relation to or retroactive effect on the preceding bankruptcy—no different from the acquirer’s raising of prices in response to some new and unanticipated excise tax imposed after the acquisition. Under this account of successor liability, future claimants’ recoveries come from the acquirer and its customers. They do not affect or come at the expense of the estate in the manufacturer’s bankruptcy. Therefore, bankruptcy law should have no effect on postbankruptcy successor liability.

This after-the-fact perspective, however, ignores the ex ante effect of successor liability on the negotiation over sale of the business. The acquirer’s ex ante reaction to successor liability risk will be the same in bankruptcy as outside. It will reduce its bid price to account for the risk, thereby reducing the size of the common pool and forcing current claimants to subsidize full

274 Therefore, application of postbankruptcy successor liability would not depend on whether a future claimant had received any distribution in bankruptcy. See Wilkerson v. C.O. Porter Machinery Co., 567 A.2d 598, 606 and n.15 (N.J. Super. 1989) (holding that postbankruptcy claimant was entitled to sue acquirer for full amount of claim, even though claimant had failed to take steps to recover partial compensation available under liquidating plan at issue; and that recovery of partial compensation under plan would not have precluded claimant from recovering shortfall from acquirer).

275 See, e.g., id.: The second Ray justification, “the successor’s ability to assure the original manufacturer’s risk-spreading role,” suggests no reason why a purchaser in bankruptcy is any less able to insure against contingent products liability claims than any other purchaser. Our Supreme Court has clearly expressed the intention to allow persons injured by defective products to recover against those who can best spread the risk of such injury.

Id. at 602 (citing Ramirez v. Amsted, 431 A.2d 811, 819 (N.J. 1980).

276 See supra note 75 and accompanying text.
recoveries for future claimants.\textsuperscript{277}

The notion that successor liability’s purpose is primarily ex post causes courts to ignore or trivialize ex ante effects.

\[\text{[W]hatever happens to [the acquirer] in [the claimant’s] pursuit of this claim will have no effect on the bankruptcy proceeding—that is over and done with and the debtor . . . has ceased to be. The [claimant’s] suit, a full two years after the bankruptcy case has closed, “cannot possibly affect the amount of property available for distribution to [the debtor’s] creditors; all of [the debtor’s] property has already been distributed.”}\textsuperscript{278}

If there is any dampening of the bidding for the going concern, such an effect is merely incidental.\textsuperscript{279} In like manner, the post hoc loss spreading view creates confusion concerning the relevance of bankruptcy priorities and equal treatment

\textsuperscript{277} See supra notes 253-256 and accompanying text.

\textsuperscript{278} Chicago Truck Drivers, Helpers and Warehouse Workers Union Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 51 (7th Cir. 1995) (quoting Zerand, 23 F.3d at 162). While not a products liability case, Chicago Truck Drivers echoes Zerand’s skepticism of the bid-dampening effect of postbankruptcy successor liability. See supra note 266 and accompanying text.

Ironically, this analysis in Chicago Truck Drivers is largely gratuitous. The “sale” at issue in that case was not even a bankruptcy sale. Instead, insiders of the Chapter 7 debtor acquired the debtor’s assets through a collusive foreclosure. The insiders purchased the claim and security interest of the debtor’s secured lender and then obtained relief from stay to “foreclose” on the debtor’s assets. See Chicago Truck Drivers, Helpers and Warehouse Workers Union Pension Fund v. Tasemkin, Inc., 172 B.R. 877 (N.D. Ill. 1994), rev’d, 59 F.3d 48, 51 (7th Cir. 1995). In this situation of course, neither the debtor nor its insiders attempted to obtain any type of “free and clear” sale order from the bankruptcy court, since the court neither sanctioned nor oversaw the rigged sale. While the holding—that successor liability was not precluded by the preceding bankruptcy in that case—may therefore have been correct, the appeals court was unwilling to engage the Bankruptcy Code, refusing to consider the distinction between a collusive foreclosure outside of bankruptcy and a free and clear sale within bankruptcy. See Chicago Truck Drivers, 59 F.3d at 50 n.2. Instead of a narrow decision justifiable on the unusual facts of that case, the court made broad assertions generally downplaying the significance of the bid dampening and equal treatment problems that postbankruptcy successor liability may cause. See id. at 50-51.

Moreover, the claimant involved was not even a future claimant, but a pension fund that had filed a claim in the preceding no-asset Chapter 7 and, as with other unsecured creditors, had received no distribution.

\textsuperscript{279} See Chicago Truck Drivers, 59 F.3d at 50; Zerand, 23 F.3d at 163; Wilkerson, 567 A.2d at 606 n.14.
among future claimants and other creditors. If future claimants’ recoveries come merely at the expense of the acquirer and its customers among whom losses are spread, and not at the expense of the common pool, the issue of undeserved priority for future claimants is assumed away.280

2. Cost Internalization and Bankruptcy

The cost internalization rationale for successor liability highlights the fundamental point that future claimants are the manufacturer’s creditors. It also makes clear that—at least outside of bankruptcy—the acquirer’s discounting of its bid is exactly what is supposed to happen as a consequence of successor liability. Far from incidental, that result is the central point to successor products liability. The reduced sale consideration to the manufacturer

280 See Chicago Truck Drivers, 59 F.3d at 51 (“Once a bankruptcy proceeding is completed and its books closed, the bankrupt has ceased to exist and the priorities by which its creditors have been ordered lose their force.”). See also R.C.M. Executive Gallery Corp. v. Rols Capital Co., 901 F. Supp. 630 (S.D.N.Y. 1995):

Once the bankruptcy proceeding is completed, the ordering of creditors is meaningless because the bankrupt has ceased to exist. If a plaintiff pursues a claim under the theory of successor liability, the success of such a claim can have absolutely no effect on the availability of funds for other creditors because all of the debtor’s funds have been distributed. Furthermore, . . . even a plaintiff who unsuccessfully sought relief in the bankruptcy proceeding should be permitted to assert a claim under successor liability principles. Although prior opportunities for relief are relevant for determining whether to allow successor liability, they are not dispositive. After all, . . . “a second chance is precisely the point of successor liability.”

Id. at 638 (quoting Chicago Truck Drivers, 59 F.3d at 51). RCM was another case in which the court went far out of its way to make broad pronouncements concerning the effect of bankruptcy on successor liability claims. As with Chicago Truck Drivers, the case involved not products liability but federal successorship doctrine, in this case for private RICO liability. The case did not merit broad pronouncements on successor liability and bankruptcy, since the plaintiff had never received notice of the bankruptcy, and the case did not even involve an arms'-length transaction but arguably a sham sale. Id. at 638. As in Chicago Truck Drivers, the court’s refusal to preclude the successor liability claim was the correct result, but the gratuitous analysis concerning bankruptcy and successor liability is troublesome.
effectively forces internalization of its costs. The endgame losses from future injuries are shifted to the manufacturer and its shareholders, where they belong.\footnote{See supra Part II.C.1.} This observation also has important consequences for bankruptcy analysis.

In the nonbankruptcy context, in addition to its tort deterrence and victim compensation goals, successor liability in effect responds to an absolute priority problem. Absent successor liability, shareholders of the dissolving corporate tortfeasor receive distributions that rightly belong to certain creditors, namely future claimants.\footnote{See text accompanying supra notes 91-92.} However, bankruptcy’s collective proceeding may largely solve this problem for future claimants. Once the bankruptcy process has been invoked, successor liability is unnecessary.

Bankruptcy accelerates all debts against the debtor,\footnote{See HOUSE REPORT, supra note 154, at 353 ("[B]ankruptcy operates as the acceleration of the principal amount of all claims against the debtor."). See also Jackson, Translating Assets and Liabilities, supra note 117, at 80-81 (characterizing rule of bankruptcy acceleration as "off the rack" contract term).} which forces an accounting that should include future claims liability. Estate assets are distributed according to absolute priority,\footnote{See supra note 105 and accompanying text.} so that future claimants’ priority over shareholders will be respected. By contrast, even though creditors are also meant to be paid ahead of shareholders upon dissolution under state law,\footnote{See supra note 80 and accompanying text.} there is typically no state law mechanism to force inclusion of future claims in the
accounting. Provided that future claims are recognized in bankruptcy and share in the common pool of assets, their disability under state law dissolution is eliminated.\footnote{Certainly the time delay between the debtor’s obligation-creating activity and the manifestation of the injury creates practical difficulties, both in and out of bankruptcy. But these difficulties do not alter the future claimant’s fundamental posture as a creditor of the manufacturer-debtor.} Future claims will be paid, while not likely in full, at least ahead of shareholders.\footnote{Assuming the debtor’s insolvency, any returns to shareholders would violate the absolute priority rule, and would therefore be permissible only through creditor consent. 11 U.S.C. § 1129(b) (1994). The likelihood of any return to shareholders in external reorganization is remote.}

What about cost internalization and its tort deterrence and victim compensation objectives? Assuming the debtor is insolvent,\footnote{Taking account of future claims will probably show the debtor to be insolvent, if it was not already. For example, in the Manville case, there was apparently some confusion over the debtor’s solvency, but by the time of confirmation, it was clear that accounting for future asbestos claims rendered the debtor insolvent. See Lynn M. LoPucki and William C. Whitford, \textit{Bargaining Over Equity’s Share in the Bankruptcy Reorganization of Large, Publicly Held Companies}, 139 U. Pa. L. Rev. 125, 173 (1990) (discussing confusion over debtor’s solvency that led to confirmation of plan paying pendency interest to unsecured bank and trade creditors).} then as in the nonbankruptcy context, further attempts at forcing cost internalization are futile. By that point, the threat of successor liability—and tort liability generally—has ceased to provide any deterrence.\footnote{Moreover, there is no ex ante deterrent effect either. See discussion \textit{supra} p. 37.} Losses exceed the firm’s value, and any successor liability discount merely charges current creditors to pay future

\footnote{In the unlikely event that the debtor were solvent after taking future claims into account, then all creditors, including future claimants, would be paid in full, with interest, ahead of the debtor’s shareholders. See 11 U.S.C. §§ 726, 1129(a)(7) (1994). Inclusion of future claims and the rule of absolute priority ensures internalization of the solvent manufacturer’s costs.}
claims.290 The depressing of bids and the discount in sale proceeds comes not at the expense of the firm or its shareholders—shareholders have nothing to lose once the firm is insolvent—but at the expense of creditors as a group. No deterrence purpose has been served.291

With respect to victim compensation, we might sympathize with the future tort victim whose injury manifests itself only long after the corporate tortfeasor has disappeared.292 Even when she is included in the bankruptcy distribution, her share of the common pool may not be enough to compensate fully for her injuries. But the impulse to compensate future tort claimants through successor liability has no conceptual justification following bankruptcy.

Recognizing the special vulnerability of tort creditors does not justify divergent treatment as between current and future claimants, or between current and future tort victims. In the context of external reorganization, successor liability favors future over current claimants, including known tort victims. It enables full recovery only for future tort victims. It does not operate to favor tort and other involuntary claimants over contract creditors. It effectively shifts losses from future claimants—providing them full compensation—to the tortfeasor’s residual claimants. But in bankruptcy, the

290 See discussion supra p. 37.

291 The equal treatment rule has also been breached. See supra notes 255-256 and accompanying text.

292 While voluntary creditors have some ability to diversify across more than one borrower and to “adjust” for credit risk, tort victims do not choose their “borrowers”—that is, their tortfeasors. Tort creditors are therefore in a precarious position, and future tort creditors even more so. See discussion supra p. 17.
residual claimants will be other creditors, including the future claimants’ fellow tort victims whose injuries have already appeared, as well as other involuntary creditors.\textsuperscript{293} Others have argued for special treatment of tort creditors generally.\textsuperscript{294} However, short of any fundamental change, tort creditors are merely unsecured creditors under the current system. The future tort victim deserves no less, but also no more, than the current tort victim or other unsecured creditor.

Under a cost internalization approach, then, even on its own terms, successor liability is unnecessary following an external reorganization that takes account of future claims. Inclusion of future claims in bankruptcy and their absolute priority over shareholders give future claimants their due under a cost internalization approach to successor liability. Bankruptcy in addition requires future claimants’ equal treatment with other unsecured creditors.\textsuperscript{295}

That future tort victims may not be paid in full in bankruptcy does not imply that successor liability is appropriate. No tort victim or other unsecured creditor will be paid in full. Receiving her due from the bankruptcy

\textsuperscript{293} See \textit{supra} note 89.

\textsuperscript{294} Recognizing that tort creditors are different from contract creditors, theorists have proposed special treatment for tort claimants—either modification of corporate limited liability rules with respect to them, see Hansmann & Kraakman, \textit{supra} note 85, at 1907; the granting to them of priority over secured and/or other contract creditors, see LoPucki, \textit{The Unsecured Creditor’s Bargain}, \textit{supra} note 23; or both. See Leebron, \textit{supra} note 89.

\textsuperscript{295} Moreover, even if it were decided that tort creditors should enjoy priority over secured creditors and/or other creditors, that priority ought to be effected in the bankruptcy distribution, for both manifested and future tort victims, not through successor liability. The collective bankruptcy proceeding is superior to successor liability for effecting any distribution involving future claims, regardless of the priority scheme chosen.
proceeding should preclude the future claimant from a second recovery. Further rights against the acquirer must be terminated for the collective good.
VI. IMPLEMENTATION

Having concluded that future claims must always be included in external reorganization and receive equal treatment with current creditors, and that successor liability claims must be extinguished, we turn in this Part to issues of implementation.

A. Prospects for the Traditional Model

Appropriate methods for implementing comprehensive inclusion of future claims will vary depending on the size of the case and the perceived magnitude of future claims liability. In terms of aligning practice with theory, the truly difficult cases will involve small and medium-sized companies, for which administrative expenses will always be of special concern. Outside of the large cases, the “traditional model”\textsuperscript{296} may be cost prohibitive. Each element of the approach—the future claims representative, claims estimation, a claims resolution facility and associated trust—becomes relatively more expensive as the size of the estate gets smaller, but the due process and other concerns remain the same.\textsuperscript{297}

Collectivizing some aspects of the traditional model, however, may be possible consistent with the rights of future claimants. Institutions already exist that might be adapted for this purpose. For instance, while appointment of a future claims representative may not be cost-justified in each case,\textsuperscript{298} perhaps a

\textsuperscript{296} See supra Part IV.C.1.

\textsuperscript{297} See supra Part IV.C.2.

\textsuperscript{298} Whether due process requires appointment of a future claims representative in bankruptcy is
A panel system could be devised, similar to the current system of panel trustees for Chapter 7 cases. The small cases may not be lucrative for a “panel future claims representative,” but a balance of small and larger cases could provide sufficient compensation to entice lawyers to want to serve. 299

Estimation as well need not be an extravagant proceeding, but might be tailored to what the estate can bear. As resort to claims estimation increases, one would hope that more accurate, less expensive methods will develop. 300 No estimation will be perfect in any event. As long as the procedure chosen provides reasonable accuracy and does not systematically bias the outcome in either direction, it may be a legitimate exercise of bankruptcy powers. 301

an unsettled question. Compare Ralph R. Mabey & Jamie Andra Gavrin, Constitutional Limitations on the Discharge of Future Claims in Bankruptcy, 44 S.C. L. Rev. 745, 781 (1993) (“Mullane usually mandates . . . the appointment of a future claims representative in order to provide future claims access to a court hearing.”) with Frank R. Kennedy & Gerald K. Smith, Postconfirmation Issues: The Effects of Confirmation and Postconfirmation Proceedings, 44 S.C. L. Rev. 621, 692 (1993) (“It is . . . arguable whether either [the Fifth or Fourteenth Amendment] embraces the notion that a representative must always be appointed to represent the claims of unknown claimants.”). However, implementing the traditional approach without representation for future claimants seems problematic. It would seem, for example, that future claimants would have to be represented in any estimation proceeding purporting to limit their recoveries by capping the debtor’s aggregate liability. See supra note 143 and accompanying text.

299 Chapter 7 trustee fees are tied to the level of disbursements made in a given case. See 11 U.S.C. § 326(a) (1997) (describing fee schedule for Chapter 7 trustee). Because most Chapter 7s are “no-asset” cases, the trustee is paid only a nominal fee for her services in those cases. Most cases are therefore not lucrative for a panel trustee, but the compensation from the “asset” cases ultimately makes up for having to administer the “no-asset” cases. See Warren, supra note 93, at 365 (describing cross-subsidization of trustees’ fees).


301 See Jackson, Logic and Limits, supra note 93:

It may be in the interests of all the claimants to expedite the [claims liquidation]
The same may be said for the claims resolution mechanism. The costs of full-blown nonbankruptcy litigation “may make little sense when the resulting claim will receive only ten cents on the dollar. The relatively fixed costs . . . associated with nonbankruptcy claim liquidation procedures may loom unduly large when translated into the bankruptcy forum.” The streamlined claims resolution mechanisms adopted in the large cases, while perhaps not exemplary in all respects, may at least provide some lessons for smaller cases. Alternative dispute resolution mechanisms, for example, would seem to make eminent sense in terms of transaction cost savings. As with future claims representation, the claims resolution function could be collectivized and cross-subsidized, with staffing either by private parties or public officials.

The cost of the claims resolution process, of course, will turn in part on the nature of the tort and the complexity of the eligibility criteria set as part of the reorganization plan. As with any administrative or adjudicative process and thereby scale down its costs. For that reason a bankruptcy system might legitimately adopt its own procedures for estimating the expected value of a claim if successful and the probability of its success. Although the normal nonbankruptcy trial procedures may be watered down or eliminated, as long as there is no bias in the direction of estimation, then there is no particular reason to think that the value of those nonbankruptcy procedural rights has been interfered with.

Id. at 45 (emphasis in original).

In addition, formal estimation may not always be necessary. In some circumstances, acquirers might be willing to purchase businesses subject to overhanging future liabilities if they could get comfortable with the potential range of costs. Formal fixing or capping of the liability may therefore not be necessary, either to preserve going concern value or to assure compensation to future claimants. Based on this idea, I have proposed a low-cost approach to treatment of future claims in external reorganization infra at Part VI.B.

302 Id.

303 See supra note 144 and accompanying text.
process, attempting relatively finer distinctions will generally result in relatively
greater resolution costs. Transaction cost considerations should therefore inform
not only the structuring of the claims resolution process but also the
determination of substantive eligibility criteria.\(^{304}\)

With respect to the payment trust, collectivized administration
seems to hold the most promise. Each case involving future claims does not
require its own separate asset management and distribution system. Once the
level of future claimants’ pro rata recovery is set,\(^{305}\) a claims resolution
procedure put in place, and estate assets set aside, asset management and
payment of claims are simply investment and administrative functions,
respectively, requiring no exercise of legal discretion on the part of
administrators.\(^{306}\) Public and private institutions already exist that perform
similar functions. Insurance and trust companies sell similar services in the
private sector. As the legal system adapts itself to address future claims issues

\(^{304}\) In the Robins case, for example, the claims resolution facility offered claimants a menu of
procedural options, see supra note 144, with more expensive claims requiring more information
and more process. “The more compensation sought by a claimant, the more information the
fund required.” McGovern, supra note 147, at 682. In this manner, the fund let claimants
“self-select the optimal combination of price and transaction costs.” Id.

\(^{305}\) After estimation of aggregate future claims liability, discounted to present value, current
and future claimants’ payout ratio is set simply by dividing asset sale proceeds—net of
administrative expenses and other priority claims—by the total amount of current and future
claims.

\(^{306}\) This is not to suggest that management of the trust assets would simply be mechanical.
Different investment strategies may affect recoveries for some future claimants, depending on
when their respective claims mature. However, assumptions concerning reasonable investment
returns were presumably incorporated into the future claims estimation process, in order to
determine the proper amount of estate assets to allocate to future claimants. A prudent
investment strategy and corresponding investment guidelines would seem to be uncontroversial
in this context.
more coherently and comprehensively, demand for low cost solutions will no doubt increase. Trust and insurance products designed specifically for future claims administration and compensation may not be too far off.\textsuperscript{307}

Bankruptcy trustees perform similar functions as well. Trustees in Chapter 13 consumer cases and Chapter 7 liquidation cases hold and manage estate assets and disburse innumerable small payments to commercial and other creditors. And these systems are self-supporting.\textsuperscript{308} The increasing likelihood of the existence and recognition of future claims in smaller business bankruptcies suggests that a government institution for collective asset management and distribution on behalf of future claimants may be appropriate.

\textbf{B. One Alternative: Commensurate Discounted Assumption}

The traditional model may not be the only option for addressing future claims. One plausible alternative, which I call Commensurate Discounted Assumption (“CDA”), may avoid the costs of formal estimation of future claims liability and the expense of establishing and maintaining a trust to distribute future payments. A future claims representative may also be unnecessary in some instances.

1. \textit{The Idea}

Under CDA, the acquirer simply assumes the obligation to pay

\textsuperscript{307} Professor Keating has suggested that the assets set aside for future claimants be used to purchase insurance on their behalf, instead of simply placing such funds in trust. \textit{See} Keating, \textit{supra} note 96, at 1101-02.

\textsuperscript{308} \textit{See} Warren, \textit{supra} note 93, at 364-65 (describing profit making by U.S. Trustee system and fee system for private trustees).
future claims as they mature and are liquidated—but at a discount. Each future claimant would be entitled to pro rata payment of its claim from the acquirer, at a percentage commensurate with current creditors’ actual recoveries from distribution of sale proceeds under the liquidating plan. The required percentage payout to future claimants would be determined implicitly, based on the results of negotiation among the acquirer, the debtor, and current creditors over the purchase price for the business. Whatever percentage recovery is received by current creditors based on a pro rata distribution of all sale proceeds among them, that percentage recovery will also determine the extent of the acquirer’s liability and future claimants’ entitlement.

For example, if current claims of $70 million share $7 million in sale proceeds after administrative and other priority claims are paid, that 10% payout also sets the acquirer’s commensurate liability—and the “CDA payout ratio”—for future claims. As future claims mature and are liquidated, the acquirer must compensate each at 10% of the amount of its liquidated claim.

An acquirer would certainly discount its bid price to account for this assumed CDA liability, but this should not prejudice current creditors, since any discount would only reflect the cost of payments to future claimants commensurate with those received by current claimants. The common pool represented by the asset sale proceeds would contract, but only by the amount of pro rata payments to which future claimants are entitled.

Assume, for example, that the acquirer estimates the operational value of the business at $10 million. It estimates aggregate future claims
liability at $30 million in present value terms, and there are current claims totaling $70 million. Under these assumptions, and assuming no secured debt, and administrative and other priority claims to be zero (purely for ease of computation), the acquirer will not bid the “full price” of $10 million for the business. Instead it will bid $7 million, taking a $3 million discount for future claims liability. Because it estimates that future claims constitute 30% of the debtor’s unsecured claims, it will reserve 30% of its “full price” bid to compensate future claims as they arise.\(^{309}\)

As a result of the acquirer’s $7 million bid, current claims of $70 million will be paid 10% of their claims, which also sets the acquirer’s commensurate liability for the estimated $30 million in future claims. Over time, the acquirer will end up paying a present value of $3 million in order to retire future claims as they mature, each at 10% of its claim. In this way, the “full price” of $10 million is shared ratably among current and future claims.

In effect, this process allows protection of future claimants’ interests through the bargaining of current creditors, the debtor and the acquirer over the purchase price of the business. Current creditors will push for a high valuation of the going concern, with a minimal discount for any future claims liability, thereby maximizing returns to themselves. The acquirer’s approach will be just the opposite. It will wish to pay as little as possible for the going concern, and to that end will claim a heavy burden of future claims liability.

\(^{309}\) The acquirer will also attempt to discount for its anticipated transaction costs of liquidating future claims as they mature.
Because the ultimate percentage payout received by current creditors will affect the acquirer’s assumed obligation to pay future claimants, the acquirer has additional incentive to bid low.

The advantages to this approach are several. First, the parties in interest can avoid the costs of a formal estimation proceeding. Parties will certainly have to invest resources privately estimating future claims liability, which will inform their negotiation over the sale price. However, no formal estimation process need be conducted, and no current representation for future claimants need necessarily be procured. As long as current creditors have a large enough stake in the outcome to police or participate in the bargaining over the purchase price, future claimants are protected by current creditors’ desire to maximize their own returns. This approach also eliminates the need for a special mechanism to effect future distributions. Future claims would simply be paid by the going concern—that is, the acquirer—as they arise and are liquidated.

Future claims are not prejudiced, as their recoveries have not been limited by any formal estimation. Only the acquirer’s commensurate liability—and the corresponding CDA payout ratio—is set as a result of the bankruptcy sale. Each future claimant’s actual recovery from the acquirer would be determined upon the claim’s liquidation by multiplying the liquidated face


311 A streamlined claims resolution process could also be set up in bankruptcy as part of the liquidating plan.
amount by the CDA payout ratio. 312

This bargaining structure in effect uses a crude market mechanism to substitute for future claims estimation. It allows parties with their own money at stake to negotiate a deal that also determines treatment of future claimants. Because it is their money at stake, we can have some confidence that current creditors and the acquirer will be vigorous in their negotiation. And whatever deal is struck, future claimants will receive equal treatment with current creditors, discounted to present value.

In effect, the acquirer pays the “full” purchase price in multiple installments. The first installment is paid to the Chapter 11 estate in order to acquire formal title to the business. The first installment—net of administrative expenses and other priority claims—goes to pay current creditors, who are the debtor’s residual claimants whose identities have been determined as of the date of plan confirmation. Further installments are paid to future claimants—that is, the residual claimants whose identities are determined postbankruptcy—as their claims mature.

2. Limitations and Implications

Certain caveats apply to this CDA approach.

a) Due Process

One obvious caveat relates to due process. Absent appointment of a future claims representative, it is unclear whether the interests of future

312 Building on the example in the text, the future claimant whose injury has matured and whose claim is liquidated at a face amount of $100,000 will be paid 10% of that, or $10,000, by
claimants could be said to have been adequately represented in the bargaining process. No party to the bankruptcy would have the same set of interests as future claimants.  

On the other hand, as long as the particular circumstances in a given case impart confidence that the debtor, current creditors, and the acquirer bargained at arms’ length over the purchase price for the business, then future claimants’ interests would seem to have been protected. Future claimants’ interests coincide with current creditors’ in holding out for the highest possible purchase price, since that dollar figure provides the numerator for the fraction that is the CDA payout ratio. Future claimants would also want to minimize the denominator of that fraction, which is simply the dollar amount of allowed current claims. Presumably the debtor and current creditors may be relied upon to raise allowance issues with respect to current claims, since current creditors stand to improve their recoveries to the extent they can eliminate other current creditors claiming a share in the sale proceeds. As long as no side payments are allowed from the acquirer to current creditors, and as long as current creditors have enough stake in the outcome to participate, it would appear that the bargaining interests of current creditors also serve to protect future claimants’

Cf. Hansberry v. Lee, 311 U.S. 32, 43 (1940) (opining that absent parties may be bound where they are adequately represented by present parties): “[W]here the interests of those not joined are of the same class as the interests of those who are, and where it is considered that the latter fairly represent the former in the prosecution of the litigation, the court will proceed to a decree.” Id. at 41.
interests.\textsuperscript{314}

Due process protection for future claimants is certainly an important issue. However, it would be ironic if due process constraints were construed to defeat the interests of the supposed beneficiaries of those constraints.\textsuperscript{315} If due process concerns preclude bankruptcy participation by future claimants in the small cases because the traditional approach is cost prohibitive and no other approach will do, many excluded future claimants may end up with no recovery at all. State law remedies may be nonexistent. That consideration should inform any due process analysis.

\textit{b) Successor Liability Issues}

The CDA approach implicates successor liability concerns. It is at heart a species of successor liability, but with a bankruptcy twist. As such, it is

\begin{quote}
\textsuperscript{314} “[T]here has been a failure of due process only in those cases where it cannot be said that the procedure adopted, fairly insures the protection of the interests of absent parties who are to be bound by it.” Hansberry, 311 U.S. at 42.
\end{quote}

Notice should also be given. Some future claimants may be identifiable, and as to them actual notice is appropriate. See Tulsa Prof’l Collection Servs., Inc. v. Pope, 485 U.S. 478 (1988) (holding that creditor known or reasonably ascertainable is entitled to notice by mail or other means of actual notice); Waterman S.S. Corp. v. Aguiar (In re Waterman S.S. Corp.), 157 B.R. 220 (S.D.N.Y. 1993) (describing notice requirements with respect to known versus unidentifiable future claimants). Publication notice should also be made for unidentifiable claimants. While no future claimant may have any incentive to participate, see supra note 10 and accompanying text, to the extent practicable, future claimants should be given an opportunity to appear, if for no other purpose than to monitor the transaction that will affect their potential future recoveries.

Ultimately, if there is doubt concerning due process questions, a future claims representative could be appointed. For example, if future claims liability far outweighed current claims liability, current creditors might have no strong incentive to police the bargaining over the purchase price for the business. In that situation, appointment of a future claims representative might be necessary.

\begin{quote}
\textsuperscript{315} See generally Roe, Mass Tort, supra note 2, at 898-904 (noting possible detriment to future claimant’s interests from too formalistic a construction of due process requirements).
\end{quote}
susceptible to criticisms of the same flavor as those aimed at state law successor liability.\textsuperscript{316} Asking an acquirer to assume open-ended liability may kill any deal\textsuperscript{317} The parties’ respective assessments of the present value of aggregate future claims liability may differ by a wide margin. To the extent that the aggregate amount of liability is difficult to predict within an acceptable range of uncertainty, the parties may not be able to settle on a mutually acceptable price for the business.

On the other hand, with the liability discounted, the acceptable range of uncertainty becomes proportionally greater, since each dollar of unexpected liability is paid only a proportionate amount based on the CDA payout ratio. The effect of scaling down the liability is that the deal can tolerate a higher degree of uncertainty than outside of bankruptcy.

Moreover, the CDA approach is not mandatory. It merely provides one alternative for the parties to structure a deal that also accounts for future claims. Compensating future claimants is mandatory. But whether that obligation is paid by the estate directly—as occurs under the traditional approach—or the acquirer assumes it, is up to the parties to decide. Presumably,

\textsuperscript{316} See supra note 62 and accompanying text.

\textsuperscript{317} “Open-ended” may be a bit of overstatement. An acquirer may limit its CDA liability simply by placing the acquired business in a separate corporation and incurring secured debt. Liability would thereby be limited to the consideration paid for the business net of the secured debt. See LoPucki, The Death of Liability, supra note 42, at 14-23 (describing liability avoidance strategies of secured debt and multiple incorporation). Of course, there may be financing issues that make secured debt undesirable. There may be operational reasons to integrate the acquired business into the acquirer’s existing operations, in which case separate incorporation might not be effective to quarantine the liability of the acquired business. See In re Palmer Trading, Inc., 695 F.2d 1012, 1017 (7th Cir. 1982) (discussing commingling of business affairs among affiliates as factor in favor of piercing corporate veil).
whichever route is cheaper in transaction cost terms would be preferred. Any approach attempting formally to cap future claims liability would require an estimation proceeding at which a future claims representative would participate. But that route may be cost prohibitive. The CDA approach may be the cheaper option. In the face of acquirer hesitance at CDA liability, current creditors might have no choice but to consent to whatever discounted sale price may be necessary to sell the going concern.  

\[318\]

\[c)\] *Transaction Costs in Claim Resolution*

Another effect of scaling down future claims liability is that future claimants’ transaction costs in pursuing their claims become a relatively greater deterrent to engaging in such pursuit. If the CDA payout ratio is low, future claimants may not find it worthwhile to take the steps necessary to recover pennies on the dollar for their tort harms.

In this situation, the design of a low cost claims resolution mechanism may be critical to ensuring that compensation is ultimately delivered. Otherwise, the acquirer’s CDA liability is merely theoretical. The acquirer, the debtor and current creditors could negotiate the sale of the business under the comfortable assumption that few future claimants would ever come forward. Any scaled down recovery would not be worth future claimants’ efforts. The going concern sale in bankruptcy would therefore as a practical matter leave future claimants with no remedy.

\[318\] Under my proposal, piecemeal liquidation is no more attractive an alternative, since current creditors will have to share with future claims even in that event. See supra note 223.
C. Policing Inclusion of Future Claims

Even if a costless scheme could be devised for inclusion of future claims in external reorganization, there remains the general problem of mandating its use. Even if the CDA approach “works,” no one before the court may have any interest in raising it or proposing any compensation for future claims.319

In some cases, the acquirer may insist that future claims be addressed.320 It may seek a CDA order, as that would reduce its liability as compared to full blown successor liability outside of bankruptcy.321 However, that incentive is only as good as the threat of successor liability, which as we have seen is spotty.

If the external reorganization fails to make provision for future claims, and foreseeable future claims appear nevertheless, the future claimant should be able to seek relief from the bankruptcy court against the acquirer. At the least, the court should imply the acquirer’s CDA obligation to the future claimant.322 The future claimant’s position as a residual owner of the business in

319 Appointment of a future claims representative does not occur spontaneously. See supra note 188 and accompanying text. Of course, future liabilities might arise that could not have been anticipated at the time of bankruptcy. That these liabilities were ignored in bankruptcy is understandable. They present a much more difficult question than anticipated products liability. See supra note 84. A considered discussion of this question must be deferred for another day.

320 In Piper, for example, it was the acquirer’s insistence that led to appointment of a future claims representative. See supra note 170.

321 See supra notes 170-171 and accompanying text.

322 Cf. Jackson, Translating Assets and Liabilities, supra note 117: “Existing claimants may use bankruptcy to discharge [future] tort liability at an appraisal that they (or the debtor) know
bankruptcy entitles her to demand equal treatment with her fellow owners—that is, the other unsecured creditors who have already received their distributions through external reorganization. Depending on the equities of the case, the court might impose other remedies as well.  

On the other hand, merely imposing CDA liability after the fact may be too small a stick to assure inclusion of future claims in all cases. It provides no deterrent to ignoring future claims. A more aggressive approach might deny the acquirer the benefit of any discount in liability. In other words, a future claimant not accorded acceptable treatment in external reorganization would have the right to collect 100-cent dollars from the going concern in the acquirer’s hands, purely as a matter of bankruptcy law. This remedy in fact parallels the established result in internal reorganization for a claim not afforded due process: the claim survives against the going concern.  

That approach admittedly places a premium on careful due diligence by the acquirer. However, that fact by itself should not detain us. Although prospective acquirers may wish to shy away from entanglement in the details of the bankruptcy proceeding, that position is now untenable. Courts have endorsed successor liability to protect future claimants following a

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323 For example, the debtor’s schedules are signed and filed under penalty of perjury. See 11 U.S.C. app. At 1033 (1996) (setting forth Official Bankruptcy Form 6 (Schedules)). Once it becomes clear that future claimants are creditors, debtors should be required to schedule them, at least generally, so that the court and the U.S. Trustee are on notice that future claims are an issue.

324 See supra note 185.
bankruptcy sale that ignored their rights. Acquirers have no choice but to concern themselves with future claims in bankruptcy.
VII. CONCLUSION: IMPERFECT SOLUTIONS

I have described an approach to future claims in external reorganization that mandates their inclusion in the bankruptcy proceeding and the extinguishment of any successor liability rights. The fundamental point is that future claimants, as creditors of the debtor-manufacturer, must be treated as such in the manufacturer’s external reorganization. Especially where a going concern survives to generate value for investors, future claimants are entitled to their equal share of that value.

Given the extant regimes of corporate and tort law, I have attempted to construct a balanced and conceptually consistent approach to treatment of future claims. It is unlikely that any structure exists to satisfy fully all the competing demands of predictability and finality, financial and economic rehabilitation, adequate and efficient compensation, and fairness. However rough and inelegant may be the accommodation described herein, it results from the conflicting aims of the various doctrines. Cost internalization and victim compensation cannot be perfect even absent bankruptcy. Rehabilitation and asset redeployment are likewise not costless propositions.

That goals may conflict, however, does not suggest that improvements cannot be made in their accommodation. To date, accommodation of conflicting goals has largely been at the expense of future claimants. However, their harms are real, although remote in time. The costs and consequences of delayed tort liabilities can no longer be ignored. One might take issue with the tort law system as currently configured, but reform if
undertaken should be done explicitly, and not through manipulation of corporate
and bankruptcy rules. In the meantime, corporate and bankruptcy law ought to
accord future claimants their due.

The temptation to balance competing interests on the backs of
future claimants is overwhelming. They are faceless parties with only abstract
future rights to assert. The costs of including them may tempt us to want to
ignore them instead. Especially outside of the large cases, cost-effective
solutions may be elusive. I have proposed one possible approach, which clearly
sacrifices some predictability and finality in favor of compensating future
claims. Other approaches may appear as well. We can be sure, however, that
progress will elude us until we decide to take future claims seriously.