Designing Designer Bankruptcy

Michael A. Francus*

Today's mass torts are headed to bankruptcy. Be it Purdue Pharma's opioids, United States of America (USA) Gymnastics' sexual abuse, Pacific Gas and Electric Company's (PG&E) wildfires, or Johnson & Johnson's talc, mass-tort defendants have determined that bankruptcy—not class actions, multidistrict litigation, or one-off state suits—is the way to manage their mass-tort liability.

But today's mass-tort bankruptcy is not the mass-tort bankruptcy of yesteryear, when the whole business filed for bankruptcy. Instead, these modern mass-tort bankruptcies are designer bankruptcies, where the defendant uses its corporate structure to choose which assets and which liabilities enter bankruptcy. To take today's marquee example, Johnson & Johnson, facing 38,000 tort suits alleging that its talc caused cancer, put those tort liabilities into a distinct limited liability company and had that company file for bankruptcy. Meanwhile, the remainder of Johnson & Johnson, including the division responsible for talc, continued to operate normally, staying outside of bankruptcy entirely.

This Article takes stock of those designer bankruptcies. It begins by tracing their evolution from the original Manville Model, which emerged from asbestos litigation in the 1980s, to the contemporary Texas Two-Step, made famous by Johnson & Johnson. The Article then situates these designer bankruptcies in a new theoretical framework, one drawn from organizational law, to understand the promise of designer bankruptcy (for tort victims and businesses alike) and the dangers to tort victims of being shortchanged by those designer bankruptcies. The Article then translates that framework into recommendations for Congress and for courts to better design these designer bankruptcies to capture the value of sound design while protecting tort victims.

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* Associate Professor of Law, Notre Dame Law School. Many thanks to Kenneth Ayotte, Andrew Bradt, Ralph Brubaker, Vince Buccola, Anthony Casey, Bala Dharan, John Goldberg, Chris Hampson, Howell Jackson, Melissa Jacoby, Jonathan Lipson, Joshua Macey, Robert Miller, Chris Mirasola, Chris Odinet, Billy Organek, Mariana Pargendler, Samir Parikh, Mark Ramseyer, Robert Rasmussen, Dan Rauch, Theodore Rave, Judith Resnick, Sarath Sanga, Rob Sitkoff, David Skeel, Kathy Spier, Richard Squire, Joan Steinman, Kate Waldock, Bill Watson, Julian Velasco, and participants in the Michigan Organizational Law Conference, the Harvard Law and Economics Workshop, the Civil Procedure Workshop, the American Law and Economics Association Conference, the Wharton-Harvard Insolvency and Restructuring Conference, and the Notre Dame Law School Faculty Workshop.

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Introduction

Earplugs. That's the subject of the largest litigation in the history of American courts—230,000 lawsuits alleging that Aearo, a subsidiary of the corporate giant 3M, provided defective earplugs to the United States military.[1] Unsurprisingly, those lawsuits have been consolidated and, unsurprisingly, that consolidation took the form of multidistrict litigation,[2] the landing ground for much of today's mass-tort litigation.

What's surprising is where the Aearo litigation is now: bankruptcy court. And what's more surprising is why: Aearo decided that the multidistrict litigation was a "failure," marred by "outsized verdicts," claims that "ha[d] never been vetted," a "litigation vortex," and a "flawed bellwether trial process."[3] So it simply filed for bankruptcy.[4]

And Aearo is not alone. Mass-tort defendants today are routinely opting into bankruptcy, from Purdue Pharma to the Boy Scouts to PG&E.

But today's migration of mass torts from multidistrict litigation to bankruptcy is not just about defendants' dissatisfaction with multidistrict litigation. Rather, it coincides with the rise of "designer bankruptcy"—the ability of large businesses to pick and choose which of their assets and liabilities land in bankruptcy court and which remain outside of bankruptcy.

Take Johnson & Johnson, the defendant in 38,000 lawsuits alleging that its talc powder caused cancer.[5] It too thought little of multidistrict litigation, writing of "well-documented abuses that occur in the state court tort system," "inconsistent and excessive awards," and "the costs associated with the continued litigation."[6] But instead of filing for bankruptcy itself, Johnson & Johnson availed itself of designer bankruptcy. Specifically, it put its tort liability in bankruptcy and left its business operations outside bankruptcy.[7] To do so, Johnson & Johnson created a subsidiary, LTL Management, to house all that tort liability (but none of the business's assets) and had LTL Management file for bankruptcy.[8] Meanwhile, the rest of Johnson & Johnson's business continues to operate normally outside of bankruptcy.

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1. Brendan Pierson, *How 3M Earplug Litigation Got to Be Biggest MDL in History*, REUTERS (Apr. 2, 2021, 2:45 PM), https://www.reuters.com/article/us-products-3m-idUSKBN2BP1BQ [https://perma.cc/PAV4-KJTR].

2. Transfer Order, 366 F. Supp. 3d 1368 (2019).

3. Informational Brief of Aearo Technologies LLC at 1, 3, *In re* Aearo Techs. LLC, No. 22-02890 (Bankr. S.D. Ind. July 26, 2022), ECF No. 12.

4. Voluntary Petition for Non-Individuals Filing for Bankruptcy at 1, *In re* Aearo Techs. LLC, No. 22-02890 (Bankr. S.D. Ind. July 26, 2022), ECF No. 1.

5. Informational Brief of LTL Management LLC at 48, *In re* LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021), ECF No. 3.

6. *Id.* at 1–2.

7. Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. ONLINE 38, 42 (2022).

8. *Id.*

This Article unpacks such designer bankruptcies. It begins by tracing their evolution, then it offers a new theoretical framework for understanding their design, and it concludes by suggesting solutions for Congress (and failing that, courts) for taking advantage of the promise of designer bankruptcy without running into its pitfalls.

That evolution began in asbestos bankruptcies in the 1980s. The sheer size of those bankruptcies and the effect of asbestos on dozens of major businesses called for a creative solution. And thus, designer bankruptcy was born.

The pioneer was the Johns-Manville Corporation (Manville)—at the time, the world's largest asbestos manufacturer. It faced thousands of lawsuits alleging that its products caused cancer.[9] And it filed for bankruptcy to manage the deluge of lawsuits—hundreds every month, with estimated liabilities running into the billions.[10]

In bankruptcy, Manville underwent the "corporate mitosis"[11] that is the hallmark of designer bankruptcy. It split the legacy Manville in two, creating a Trust and a successor corporation.[12] The Trust operated for the benefit of tort victims and housed all tort liability (via an injunction channeling all tort claims to the Trust) along with assets to compensate those tort victims.[13] The successor corporation received the remaining assets, including those used to operate the business, and all other business-related liabilities. The Trust went on to set up an administrative process to handle tort claims and compensate victims, much like a workers' compensation scheme.[14] And the successor corporation continued carrying on Manville's business operations, free of tort litigation and tort liability.

Congress viewed Manville's innovation as a good model for managing asbestos mass torts, which, at the time, clogged the federal courts. So Congress codified the Manville Model as § 524(g) of the Bankruptcy Code, turning corporate mitosis into the standard way of handling hundreds of thousands of claims in tens of thousands of lawsuits and dozens of asbestos

9. Kane v. Johns-Manville Corp., 843 F.2d 636, 639 (2d Cir. 1988).

10. *Id.*; KEVIN DELANEY, STRATEGIC BANKRUPTCY: HOW CORPORATIONS AND CREDITORS USE CHAPTER 11 TO THEIR ADVANTAGE 61 (1992).

11. I borrow the term from Samir D. Parikh, *Mass Exploitation*, 170 U. PA. L. REV. ONLINE 53, 57 n.21 (2022).

12. *In re* Johns-Manville Corp., 68 B.R. 618, 621–22 (Bankr. S.D.N.Y. 1986).

13. *Id.* at 624–26.

14. *See infra* section I(A)(4); Francis E. McGovern, *The Evolution of Asbestos Bankruptcy Trust Distribution Plans*, 62 N.Y.U. ANN. SURV. AM. L. 163, 163–64 (2006) (detailing the evolution of asbestos bankruptcy trust distribution plans "to deal with the scarcity of resources in the bankruptcy trust context").

business bankruptcies.[15] In turn, dozens of asbestos bankruptcies used § 524(g), and tens of billions of dollars of assets were placed in Manville Model trusts to compensate tort victims.[16]

As § 524(g) grew in popularity, innovative debtors began to plan those bankruptcies in advance. These prepackaged asbestos bankruptcies would negotiate a § 524(g) plan and then file for bankruptcy.[17] At filing, the court would be presented with a § 524(g) plan that had already received votes and was ready to be confirmed on the spot.[18] That minimized time in bankruptcy (months, not years), streamlining the complex process of reorganizing debtors with mass asbestos liability.

The most recent innovation in designer bankruptcy, the Texas Two-Step, minimizes time in bankruptcy even more by having the business avoid bankruptcy altogether. Essentially, it recreates the Manville Model's corporate mitosis, but it does so out of bankruptcy.

The first step is for the mass-tort defendant to undergo a "divisional merger," typically under Texas law.[19] In a divisional merger, the legacy company (here, our mass-tort defendant) splits in two, allocating its assets and liabilities as it pleases between the two new companies.[20] In a Texas Two-Step, the divisional merger allocates all mass-tort liability to one new entity (LiabilityCo) and all business assets to another new entity (AssetCo).[21] A funding agreement between AssetCo and LiabilityCo promises that AssetCo will pay the costs of bankruptcy and whatever amount a bankruptcy court determines that LiabilityCo owes tort victims.[22]

The second step is for LiabilityCo, and only LiabilityCo, to file for bankruptcy. That way, through AssetCo, the mass-tort defendant keeps its entire business operations in one legal entity (as with Manville's successor corporation), but that legal entity is never subject to the strictures of bankruptcy law.

These designer bankruptcies mark a shift in how bankruptcy does design. To be sure, scholars, going back to the 1980s, have identified uses of design in bankruptcy. Steven Schwarcz, for example, detailed how corporate

15. Bankruptcy Reform Act of 1994, Pub. L. No. 103–394, sec. 111, § 524, 108 Stat. 4106; STEPHEN J. CARROLL, DEBORAH HENSLER, JENNIFER GROSS, ELIZABETH M. SLOSS, MATTHIAS SCHONLAU, ALLAN ABRAHAMSE & J. SCOTT ASHWOOD, ASBESTOS LITIGATION 111 (2005).

16. CARROLL ET AL., *supra* note 15, at 88, 111 (2005); Francis E. McGovern, *Asbestos Legislation II: Section 524(g) Without Bankruptcy*, 31 PEPP. L. REV. 233, 234 (2003).

17. *See infra* subpart I(C).

18. *See infra* subpart I(C).

19. *See* Donald F. Parsons, Jr., R. Jason Russell & Koah M. Douds, The Business Lawyer—*Seventy-Five Years Covering the Rise of Alternative Entities*, 75 BUS. LAW. 2467, 2485 n.144 (2020) (noting that Delaware, Pennsylvania, and Arizona allow similar divisional mergers).

20. Francus, *supra* note 7, at 40.

21. *Id.*

22. *Id.*

structures can be (and are) used to create special-purpose entities that are, in effect, bankruptcy-proof.[23] Douglas Baird and Anthony Casey described a similar mechanism of corporate design to keep critical productive assets for an enterprise in separate corporations, creating a "withdrawal right" from bankruptcy for those assets should the enterprise as a whole fail.[24] Lynn LoPucki wrote that such maneuvers (along with other secured-debt and ownership strategies) could lead to the "death of liability," whereby corporate assets are placed beyond the reach of corporate creditors, rendering the corporate entity that commits a tort judgment proof even though the rest of the corporate family retains its assets.[25]

But design today is the inverse of bankruptcy proofing, withdrawal rights, and the death of liability. Designer bankruptcies for today's mass torts focus on after-the-fact design, not advanced planning. And they aim to put certain liabilities in bankruptcy rather than shield certain assets from it.

That shift in design also militates a shift in our understanding of mass-tort bankruptcy. Indeed, the critical insight about these "designer bankruptcies" is that they are not primarily about bankruptcy law.[26] They are not aimed at using bankruptcy to discharge liability or reorganize a business.

Instead, these designs sound in organizational law—the law of legal entities like corporations, trusts, and partnerships. Specifically, these designer bankruptcies are about asset partitioning, regulatory partitioning, and governance across legal entities. Bankruptcy just happens to be a convenient, and perhaps the only, body of law to achieve the needed organizational law maneuvers.

Take asset partitioning. As Henry Hansmann and Reinier Kraakman explain, asset partitioning is "creati[ng] . . . a pattern of creditors' rights," that is, designating distinct pools of assets for distinct creditors.[27] By way of example, when a corporation creates a subsidiary, creditors of the subsidiary

23. Steven L. Schwarcz, *Structured Finance: The New Way to Securitize Assets*, 11 CARDOZO L. REV. 607, 607 (1990).

24. Douglas G. Baird & Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations*, 113 COLUM. L. REV. 1, 5 (2013).

25. Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 4 (1996). The Bankruptcy Code itself also contemplates certain assets remaining outside of bankruptcy, like certain financial products. *See* 11 U.S.C. §§ 555 (securities contract), 556 (commodities contract), 559 (repurchase agreement), 560 (swap agreement). More recent work identifies similar phenomena in the coal industry. *See generally* Joshua Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879 (2019) (describing restructuring techniques and how various coal bankruptcies used them).

26. *Cf.* Edith H. Jones, *Rough Justice in Mass Future Claims: Should Bankruptcy Courts Direct Tort Reform?*, 76 TEXAS L. REV. 1695, 1722 (1998) (explaining that the preference for bankruptcy as a forum for resolving mass torts owes to the "raw power" of bankruptcy's tools rather than bankruptcy's connection to tort law).

27. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000).

know that they can access the subsidiary's assets for repayment (but not the corporation's), and they also know that creditors of the corporation will be able to access the corporation's assets (but not the subsidiary's).[28]

This is the same maneuver in designer bankruptcy—business creditors are designated one pool of assets (like Manville's successor corporation); tort creditors are designated another (like Manville's Trust). That is an asset partition, not a matter of bankruptcy law. Bankruptcy law happens to be a convenient mechanism for achieving that asset partition because bankruptcy acts after the liability has been incurred and thus can achieve *ex post* asset partitioning.

Next, consider regulatory partitioning. As Mariana Pargendler writes, regulatory partitioning is the use of legal entities as a "nexus for regulation."[29] Thus, for example, a French corporation may set up an American subsidiary with American citizenship if an American regulatory regime forbids certain transactions with foreign corporations.[30] Such partitions enable legal entities to opt into regulatory benefits and opt out of regulatory burdens.

In designer bankruptcy, there are three uses of regulatory partitions.[31] The first allows the tort victims' entity (like the Manville Trust) to establish an administrative scheme for compensation.[32] The second keeps creditors, and their collection efforts, in bankruptcy (for both a Manville trust and the Two-Step LiabilityCo). And the third keeps business assets outside of bankruptcy (like the Two-Step AssetCo).

The first partition uses bankruptcy to create what is essentially a workers' compensation system for resolving mass torts.[33] The aim is to create a system of claims resolution that is cheaper than litigation, more reliant on expertise, and more consistent across victims. That, as with asset partitions, has nothing to do with bankruptcy law. But bankruptcy allows a court to

28. *See id.* at 399–401 (using a company engaged in two distinct lines of business—hotel management and oil field management—as an example).

29. Mariana Pargendler, *Veil Peeking: The Corporation as a Nexus for Regulation*, 169 U. PA. L. REV. 717, 720 (2021).

30. *See* Mariana Pargendler, *Regulatory Partitioning as a Key Function of Corporate Personality*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 263, 264–65 (Elizabeth Pollman & Robert B. Thompson eds., 2021) (explaining that regulatory partitioning accounts for the creation of many corporate subsidiaries worldwide).

31. *See infra* subpart II(B).

32. *See* Deborah R. Hensler, *Alternative Courts? Litigation-Induced Claims Resolution Facilities*, 57 STAN. L. REV. 1429, 1430–31 (2005) (noting the rise of this practice in class actions and multidistrict litigation); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1395–96 (1995) (comparing compensation schemes in class actions and bankruptcy).

33. RICHARD A. NAGAREDA, MASS TORTS IN A WORLD OF SETTLEMENT 76 (2007). For criticisms of such settlement grids, see Elizabeth Chamblee Burch, *Disaggregating*, 90 WASH. U. L. REV. 667, 685–87 (2013).

impose such a scheme through a Chapter 11 plan that creates a tort trust for mass-tort victims. Hence, bankruptcy law is a convenient body of law for achieving that partition.

The second partition aims to subject creditors to both bankruptcy's burdens and its benefits. Keeping creditors in the bankruptcy court has the benefit of coordinating their collection efforts. It also prevents them from dismembering a viable business, leaving more of the business's value for victims. The burden is a loss of control for individual creditors. This is the standard tradeoff of bankruptcy and the only true bankruptcy role that designer bankruptcy invokes.[34]

The third partition is specifically aimed at *avoiding* any bankruptcy burdens for operating a business. It appears only in the Texas Two-Step, which takes advantage of the "bankruptcy partition" by keeping the operating business outside of bankruptcy entirely.[35] The result of that escape from bankruptcy is smoother functioning of the business and an easier reorganization.

The final organizational-law element in these designer bankruptcies is governance. As Robert Sitkoff writes, these are "rules that provide for the powers and duties of the managers and the rights of the beneficial owners."[36] Splitting one entity into two necessarily raises questions of governance for both entities as well as the relationship between them. And the aim is to ensure that each entity is run by those with both the ability to run it and the right loyalties.

In a situation like Manville, governance works well. Old management run the successor corporation and have the expertise to do so. They are also loyal to shareholders, which in the Manville case includes the trust, so management are maximizing value for the tort victims. As for the trust, it too is loyal to tort victims (who are the beneficiaries of the trust) and has the information needed to oversee the successor corporation. That prevents maneuvers by the successor corporation that might give the tort victims short shrift. The trustees also have the expertise to set up a compensation scheme for tort victims, ensuring that victims receive what they are owed.

But for the Two-Step, governance can pose problems for the tort victims. Management of AssetCo are loyal to shareholders, but here, unlike

34. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 10–11 (1986). Yet even this bankruptcy function may be inapplicable in cases like the Johnson & Johnson bankruptcy where the debtor is solvent, and thus there is no risk that one creditor's recovery will come at the expense of another's. *See In re* LTL Mgmt., LLC, 637 B.R. 396, 404, 418 (Bankr. D.N.J. 2022), *rev'd*, 64 F.4th 84 (3d Cir. 2023) (highlighting Johnson & Johnson's solvency).

35. For the initial use of the term, see Douglas G. Baird, Anthony J. Casey & Randal C. Picker, *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1676–77 (2018).

36. Robert H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning*, *in* THE WORLDS OF THE TRUST 428, 428 (Lionel Smith ed., 2013).

a Manville successor corporation, the tort victims own no shares. Thus, their expertise, while increasing AssetCo's value, does not aim to benefit tort victims, but instead to benefit AssetCo's old shareholders. Likewise, LiabilityCo's management will be chosen before bankruptcy by AssetCo based on their loyalty to AssetCo shareholders.[37] So no one in a Texas Two-Step is looking out for the interests of tort victims. And even the bankruptcy judge, who is not beholden to shareholders, can do little—she lacks jurisdiction over AssetCo (which is never in bankruptcy) and thus has no authority over the assets that tort victims will recover from.

This theoretical framework of organizational law reveals what designer bankruptcy is really about, along with its potential benefits, and its potential perils. And with this theoretical framework, it becomes possible to harness organizational law to better design designer bankruptcy. That means increasing the value of a bankrupt business and, in turn, channeling that increased value to the creditors, ensuring that tort victims recover more than they do in the current designer bankruptcies.

Start with asset partitioning. Organizational law shows that asset partitioning—through corporate mitosis—will be valuable whenever the mass-tort defendant continues business operations. Likewise, keeping that operational business outside of bankruptcy's regulatory partition adds value by easing the business's operations.

As for bankruptcy's regulatory partitions for tort creditors, it always makes sense to coordinate tort creditor collection efforts. That ensures tort creditors do not dismember a valuable business (limiting their overall recovery) and that early tort victims do not eat away the recovery of later ones (but rather similar injuries receive similar compensation across time). So too there is always value in establishing an administrative scheme for compensating tort victims. Such a scheme saves litigation costs, accounts for claimants over time, and ensures that compensation decisions are driven by medical expertise rather than litigation pressure.

As for governance, it is key that the tort victims' trust has the information and motivation to protect the tort victims. That requires a duty of loyalty to those victims and a duty of impartiality among them, as is standard in trust law.[38] It also requires giving the trustee access to information on the operating business to prevent machinations that favor the business's shareholders over its tort victims.

In turn, this theoretical understanding can be translated into policy by Congress and can provide guidance to courts superintending today's designer bankruptcies. For Congress, the analysis of organizational law's benefits and

37. *E.g.*, *In re LTL Mgmt., LLC*, 637 B.R. at 404.

38. Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 651, 655–56 (2004) (describing the roles of the duty of care and duty of impartiality in trust law).

perils lends itself to a statutory scheme for designer bankruptcy. For courts, the analysis highlights areas of concern that require policing, like conflicted management, weak funding agreements, hidden information, and improper shareholder control of the process.

The balance of the Article proceeds as follows. Part I describes the evolution of designer bankruptcy, from Manville to the Texas Two-Step. Part II places those bankruptcies into a theoretical framework from organizational law. Part III translates that theoretical framework into suggestions for legislation and, failing that, suggestions for courts facing that designer bankruptcy.

I. The Evolution of Mass-Tort Bankruptcy

When Congress overhauled the Bankruptcy Code in 1978, it did not contemplate bankruptcy as a landing ground for mass torts.[39] Not one provision of the new Bankruptcy Code spoke specifically to mass torts. Yet lawyers discovered the use of bankruptcy for managing mass tort liabilities early on, just a few years after the Bankruptcy Code came into effect.[40] The evolution of bankruptcy as a tool for managing mass tort is thus a testament to the work of many first-rate bankruptcy professionals; it is also a cautionary tale of how tort victims can be given short shrift.

This Part tells the story of that evolution, its many benefits, and their attendant perils. It begins with the Manville innovation that started it all, and that became the touchstone for mass-tort bankruptcy. The Part then turns to Congress's codification of that Manville Model in § 524(g), a provision of the Bankruptcy Code added to address mass-tort asbestos bankruptcies. After that, this Part looks at how mass-tort bankruptcy moved to the shadow of bankruptcy law, with prepackaged bankruptcies based on § 524(g) becoming a popular way to expedite a Manville Model bankruptcy. Last, this Part explains the Texas Two-Step, the culmination of Manville's initial innovation, which essentially recreates the Manville Model outside of bankruptcy and is the cutting edge of today's designer bankruptcies.

A. Manville

1. Asbestos.—The evolution of mass-tort bankruptcy begins with asbestos. Thanks to its strength, flexibility, and fire resistance, the mineral quickly found use in insulation everywhere from houses to ships.[41] That

39. Alan N. Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2046 (2000).

40. *See, e.g.*, Mark J. Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 2–3 (1986) ("Recent developments in the mass tort bankruptcy of the Manville Corporation have raised anew the possibility of strategic reaction.").

41. DELANEY, *supra* note 10, at 60.

pervasiveness meant that throughout the country, millions were exposed to asbestos.[42]

And exposure to asbestos can cause cancer. As early as the 1930s, reports warned of the danger.[43] A landmark study by Irving Selikoff in 1964, though, set the causal question to rest.[44]

Once it did, a deluge of lawsuits began. The earliest lawsuits were filed in the 1960s, but the floodgates truly opened in the 1970s.[45] A 1991 report from the Judicial Conference of the United States gives a sense of that deluge. In 1990, new asbestos cases were filed at a rate of 1,140 per *month*, constituting more than 6% of the entire civil caseload in the federal system.[46] That was on top of a backlog of 30,401 federal asbestos cases, which boded particularly ill as the average asbestos case took nearly twice as long to dispose of than the average personal injury case.[47] And estimates suggested that over 200,000 people would die of asbestos-related injuries (on top of those injured), auguring an unending stream of lawsuits.[48]

2. *The Manville Plan*.—The turn to bankruptcy happened in 1982, when Manville, the country's leading asbestos manufacturer, filed for bankruptcy.[49] When it filed, the business faced 16,500 suits, with 400 new ones being filed each month[50] and another 35,000 suits (with an estimated $1–2 billion in liability) projected.[51]

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42. REPORT OF THE JUDICIAL CONFERENCE AD HOC COMMITTEE ON ASBESTOS LITIGATION 2 (1991) [hereinafter JUDICIAL CONFERENCE REPORT].

43. *Id.* at 1–2.

44. *See* DELANEY, *supra* note 10, at 61 ("The asbestos manufacturers, however, claim that they did not know of the danger until 1964, when a landmark study appeared . . . "); Harold M. Schmeck Jr., *A Rare Carcinoma Believed on the Rise; Study of Asbestos Workers Shows a High Incidence*, N.Y. TIMES (Oct. 7, 1964), https://www.nytimes.com/1964/10/07/archives/a-rare-carcinoma-believed-on-rise-study-of-asbestos-workers-shows-a.html [https://perma.cc/3YHY-7LJY] ("The report . . . given by Irving J. Selikoff . . . called this 'an extraordinarily high incidence for a tumor generally so rare.'").

45. DELANEY, *supra* note 10, at 61; Eric D. Green, Lawrence Fitzpatrick, James L. Patton, Jr., Edwin J. Harron & Travis N. Turner, *Prepackaged Asbestos Bankruptcies: Down but Not Out*, 63 N.Y.U. ANN. SURV. AM. L. 727, 727, 728 n.2 (2007).

46. JUDICIAL CONFERENCE REPORT, *supra* note 42, at 7.

47. *Id.* at 8, 10.

48. *See id.* at 6–7.

49. DELANEY, *supra* note 10, at 62.

50. Marianna S. Smith, *Resolving Asbestos Claims: The Manville Personal Injury Settlement Trust*, 53 LAW & CONTEMP. PROBS., Autumn 1990, at 27, 29.

51. Frank J. Macchiarola, *The Manville Personal Injury Settlement Trust: Lessons for the Future*, 17 CARDOZO L. REV. 583, 596, 622 (1996) (discussing a consulting firm's finding that Manville would face $1 billion in liability on 35,000 new suits); *see* Smith, *supra* note 50, at 29 (estimating liability at $2 billion and projecting 50,000 to 200,000 claimants); DELANEY, *supra* note 10, at 62 (noting Manville estimated $2 billion in liability); Kane v. Johns-Manville Corp., 843 F.2d 636, 639 (2d Cir. 1988) (estimating $2 billion in liability on 50,000 to 100,000 claims); Ronald

At the time, Manville was paying its debts as they came due, which led to some controversy around the bankruptcy filing. Many questioned how a solvent, Fortune 500 company with $2 billion in annual revenues and $2 billion in assets could legitimately file for bankruptcy.[52] And many railed against the maneuver as a delay tactic.[53] Manville responded by predicting that its future liabilities and the sheer cost of litigating would prove more than the $2 billion[54]—predictions that turned out to be truer than anyone, including Manville, appreciated at the time.

What made the Manville bankruptcy truly innovative, though, was not its filing,[55] but its Chapter 11 plan. That plan created two new legal entities from the old Manville, undertaking a form of corporate mitosis through bankruptcy law. One new entity, the Personal Injury Settlement Trust, was a trust whose beneficiaries were Manville's tort victims.[56] The other new entity, the Property Damage Trust, was to address asbestos-related property claims.[57] Both trusts were split off from the reorganized Manville, which acted as a successor corporation to the prebankruptcy Manville and carried on Manville's business, but without prebankruptcy asbestos liabilities.[58]

The Personal Injury Settlement Trust was funded by a combination of cash and stock in the successor Manville. Specifically, the Trust received $150 million in cash; $695 million in insurance proceeds; 80% of the common stock in reorganized Manville; a $50 million note; various long-term bonds; and 20% of Manville's future profits.[59] All of that was to be used exclusively to pay tort victims, as the trust duties ran solely to them, not other

Barliant, Dimitri G. Karcazes & Anne M. Sherry, *From Free-Fall to Free-for-All: The Rise of Pre-Packaged Asbestos Bankruptcies*, 12 AM. BANKR. INST. L. REV. 441, 447 (2004) (estimating liability at $1–2 billion).

52. *See* DELANEY, *supra* note 10, at 70 ("Many commentators asked, 'How is it possible for an apparently sound company to declare bankruptcy?'").

53. S. Todd Brown, *Section 524(g) Without Compromise: Voting Rights and the Asbestos Bankruptcy Paradox*, 2008 COLUM. BUS. L. REV. 841, 846.

54. *See* Kane v. Johns-Manville Corp., 843 F.2d 636, 639 (2d Cir. 1988) ("From the outset of the reorganization, all concerned recognized that the impetus for Manville's action was not a present inability to meet debts but rather the anticipation of massive personal injury liability in the future.").

55. The Bankruptcy Code eliminated any requirement of insolvency for a corporate debtor to file. Frank R. Kennedy, *Creative Bankruptcy? Use and Abuse of the Bankruptcy Law—Reflection on Some Recent Cases*, 71 IOWA L. REV. 199, 202 (1985).

56. *See In re* Johns-Manville Corp., 68 B.R. 618, 621–22 (Bankr. S.D.N.Y. 1986) (discussing Manville's "Asbestos Health Trust," whose beneficiaries were Manville's tort victims). This Article distinguishes "tort claimants," and "tort victims." The former are those who bring claims in the bankruptcy. The latter are those entitled to compensation.

57. *Id.*

58. *See id.* at 622 ("To protect and preserve the Manville operating entity . . . the operating entities will be protected from further asbestos-related litigation . . .").

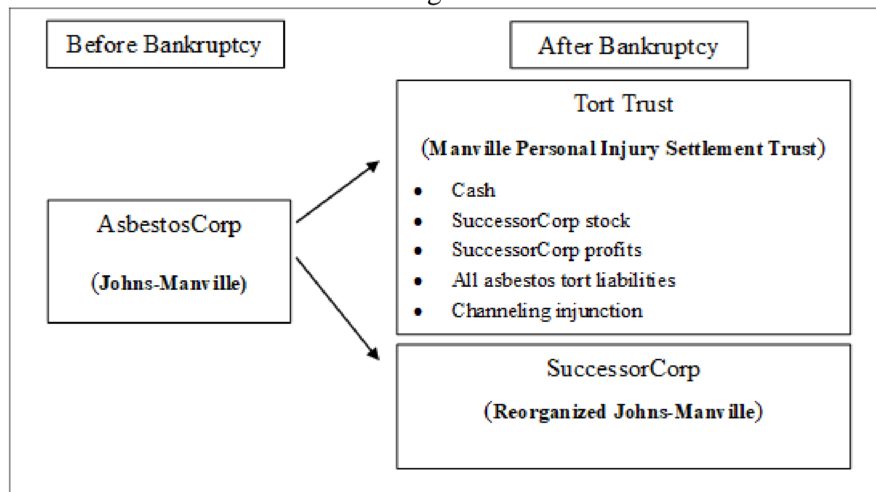
59. Macchiarola, *supra* note 51, at 600–01; *see also In re Johns-Manville Corp.*, 68 B.R. at 621 (explaining how the Trust will be funded); *In re* Joint E. & S. Dist. Asbestos Litig., 982 F.2d 721, 726 (2d Cir. 1992) (same).

Manville creditors.[60] Thus, the trustees would establish protocols to determine if a tort claimant was in fact injured and, if so, the proper recovery payment.

At the same time, the bankruptcy court entered a channeling injunction. That injunction required asbestos claimants to bring their claims to the Trust and only the Trust.[61] Thus, tort victims could not reach the assets of the successor corporation.

The successor corporation, then, contained all other assets and liabilities from old Manville. That meant everything besides the cash and stock in the Trust and the asbestos liabilities. Going forward, then, the creditors of the successor corporation (banks, employees, suppliers) would know that they could not reach trust assets but could reach all other assets if, for example, the successor corporation breached their contract. Likewise, they would know that asbestos victims could not reach the successor corporation's assets. Visually, then, the Manville Model looked like this:

Figure 1



60. *See In re Johns-Manville Corp.*, 68 B.R. at 621 ("[T]he [Asbestos Health] Trust, as a fiduciary for asbestos health victims will be the single largest stockholder in the reorganized debtor.").

61. *See* Kane v. Johns-Manville Corp., 843 F.2d 636, 640 (2d Cir. 1988) (explaining the injunction).

Tort victims overwhelmingly voted for this plan. Of the 52,440 asbestos claimants, 95.8% approved the plan and only 4.2% opposed it.[62] Indeed, the only class to vote against the plan was the class of stockholders whose interests were being diminished in favor of the tort claimants.[63]

3. The Follow-On Litigation.—Manville's innovation was not without controversy. Litigants challenged both Manville's good faith (for filing when it could pay its debts)[64] and the channeling injunction,[65] which had never before been used by a bankruptcy court.

The bankruptcy court rejected the motions to dismiss for lack of good faith. In so doing, the court noted that the Bankruptcy Code does not require insolvency for a debtor to file and is instead aimed at offering relief to debtors who need to reorganize.[66] Rejecting the argument that Manville's bankruptcy was fraudulent or a delay tactic, the court pointed out that "Manville is a real business with real creditors in pressing need of economic reorganization."[67]

Later in the case, the court found that it had authority to issue the channeling injunction.[68] It relied both on its inherent equitable power as a bankruptcy court and the codification of that power in § 105 of the Bankruptcy Code, which authorizes the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[69]

On appeal, the Second Circuit affirmed on both issues. It addressed the good faith challenge briefly, noting that "Manville honestly believed that it was in need of reorganization and that the Plan was negotiated and proposed with the intention of accomplishing a successful reorganization."[70] The four years of negotiations and the compounding asbestos liabilities undoubtedly helped prove the point that Manville needed reorganizing.

As for the channeling injunction, the court found that the tort claimants who challenged it lacked standing.[71] This saved the Manville plan. But it did

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62. *Id.* at 641.

63. *See id.* (noting common stockholders as the only class to oppose the restructuring).

64. *In re* Johns-Manville Corp., 36 B.R. 727, 730 (Bankr. S.D.N.Y. 1984).

65. *In re Johns-Manville Corp.*, 68 B.R. at 624.

66. *In re Johns-Manville Corp.*, 36 B.R. at 732, 736.

67. *Id.* at 738. "Manville is a financially besieged enterprise in desperate need of reorganization of its crushing real debt, both present and future." *Id.* at 741.

68. *In re Johns-Manville Corp.*, 68 B.R. at 626.

69. 11 U.S.C. § 105; *In re Johns-Manville Corp.*, 68 B.R. at 625 (stating that "channeling injunctions are inherently equitable"). On the "ubiquit[y]" of bankruptcy courts justifying their actions based on inherent equitable authority, and some skepticism of the argument, see generally Marcia S. Krieger, *"The Bankruptcy Court Is a Court of Equity": What Does That Mean?*, 50 S.C. L. REV. 275 (1999).

70. Kane v. Johns-Manville Corp., 843 F.2d 636, 649 (2d Cir. 1988).

71. *Id.* at 645–46.

not shore up the merits argument that bankruptcy law permits bankruptcy judges to issue such channeling injunctions.

4. Ongoing Problems.—These opinions protected Manville's plan but still left challenges for future mass-tort bankruptcies. Among them: legality, underfunding, administrative design, and future claimants.

Legality. Foremost among the challenges was legality. While the Second Circuit's opinion saved Manville's plan, it did so on standing grounds.[72] And the Supreme Court did not step in. That left uncertainty as to whether a channeling injunction of the sort entered in Manville's bankruptcy could be replicated.

Without such an injunction, the Manville Model of splitting a mass-tort defendant into a tort trust and a successor corporation (SuccessorCorp) would fall apart. The tort victims would receive the trust assets *and* the SuccessorCorp assets (because no channeling injunction would force tort claimants into the trust alone). Meanwhile, other creditors would receive *only* SuccessorCorp assets (because the trust runs for the benefit of tort victims alone).

Underfunding. As for underfunding, when the Manville Personal Injury Settlement Trust was established, the funding was based on estimated asbestos liabilities. Those estimates were that 83,000 to 100,000 claimants would file with the Trust and that the dollar value of those claims would be in the ballpark of $1 billion.[73] That estimate proved astonishingly off. By the spring of 1990, the Trust had received 150,000 claims and was already insolvent.[74] A special master's report found that the assets remaining had a value between $2–3 billion, while liabilities were around $6.5 billion.[75]

In response, largely through the efforts of Judge Jack Weinstein, the Trust distributions were redesigned.[76] Under the new Trust Distribution Plan, asbestos diseases were categorized and assigned payout values.[77] Claimants would then be entitled to a pro rata share of that value, set at 10%.[78] Were they dissatisfied, they could arbitrate with the Trust, and failing that, they

72. *Id.* at 639.

73. *See* Georgene Vairo, *Mass Tort Bankruptcies: The Who, The Why and The How*, 78 AM. BANKR. L.J. 93, 100, 104 (2004) (estimating 83,000 to 100,000 claims and potential liability of $2 billion); Macchiarola, *supra* note 51, at 596 (estimating $1 billion in liability).

74. *In re* Joint E. & S. Dist. Asbestos Litig., 982 F.2d 721, 726 (2d Cir. 1992).

75. *Id.* at 727.

76. Smith, *supra* note 50, at 28.

77. *See* McGovern, *supra* note 14, at 167–68 (explaining how trust distribution plans normally work).

78. Vairo, *supra* note 73, at 105.

could sue.[79] In essence, then, while tort claimants retained their right to a jury trial,[80] the trustees established a system for administering claims.[81]

Nor was the underfunding issue unique to Manville. The early tort trusts all struggled to repay claimants.[82] And some, like National Gypsum Company's, also required a re-funding, as Manville's did.[83]

Administration. That distribution plan mirrored a workers' compensation scheme.[84] Essentially, the trustees established a grid that listed asbestos injuries that victims might have and dollar values for payouts. To do that, though, required the trust to draw on expertise in multiple fields. For one, it needed medical expertise to understand causation and harms of asbestos.[85] Beyond that, it needed financial expertise to manage assets in the trust. And it needed lawyers to settle, negotiate, and often litigate claims, often leading to the very same litigation expenses that drove the businesses into bankruptcy to begin with.[86]

Over time, Manville Model bankruptcies improved on each of these fronts. A better understanding of asbestos harms led to more granular compensation grids.[87] And trusts shifted away from a litigation-centric model, preserving the right to a jury trial but requiring negotiation first so that claimants could not use litigation pressure to jump the settlement line or extract value simply by imposing litigation costs on the trust.[88]

Future Claimants. A final issue that arose was that of future claimants. Asbestos has a long latency period, so many injured by Manville would not see their cancer manifest for decades. The Trust, by its terms, benefitted those

79. *Id.*

80. The Court has recognized that the right to jury trial applies in bankruptcy proceedings in at least some cases. *E.g.*, Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 36 (1989). The Bankruptcy Code itself also preserves the right to a jury trial in tort cases, but only "for purposes of distribution in a case under title 11." 28 U.S.C. § 157(b)(2)(B).

81. *See* McGovern, *supra* note 14, at 175 (explaining that the system's design aims to make a jury trial unattractive in order to minimize litigation costs).

82. *See* CARROLL ET AL., *supra* note 15, at 112–13, 115 (showing that many tort trusts owed more in total claims than they had received in funding).

83. *Id.* at 112; Smith, *supra* note 50, at 32.

84. *See* NAGAREDA, *supra* note 33, at 58, 67–68 (discussing a proposed asbestos litigation compensation scheme that mirrored a workers' compensation scheme); McGovern, *supra* note 14, at 169–70 (noting stability across distribution plans).

85. *See* McGovern, *supra* note 14, at 171–72 (explaining medical criteria).

86. *See* Smith, *supra* note 50, at 29–30 (noting "legions of attorneys" are required to finalize an agreement); Macchiarola, *supra* note 51, at 602 (noting the problem of extensive litigation against the Trust); CARROLL ET AL., *supra* note 15, at 88 fig.5.1 (estimating that $40 billion in spending was spent on defense and plaintiff transaction costs out of $70 billion total spent on asbestos litigation); *id.* at 107 (noting that litigation expenses drove companies into bankruptcy).

87. McGovern, *supra* note 14, at 171–72.

88. *Id.* at 175.

future claimants as well. And early in the case, Judge Lifland appointed a legal representative to protect their interests.[89]

But estimating future injuries and preserving value enough in the Trust is a taller task than estimating current injuries—something that the Manville Trust, as described above, failed to do.[90] And nothing in the Bankruptcy Code ensured protection for future claimants in the process of negotiating a plan—it was Judge Lifland's decision alone that protected them, a decision that might not be replicated in other mass-tort bankruptcies.

This protection for future claimants would become a recurring theme. Those claimants, by definition, were not negotiating Manville's Chapter 11 plan. So they ran the risk of present victims taking all of the assets. That absence from the bargaining process compounded the mathematical challenge of determining the right dollar value to be preserved for future claimants over and against the value to be distributed immediately to present claimants.

B. The Statutory Manville Model

1. Section 524(g).—In the wake of the Manville bankruptcy, Congress saw an opportunity. Manville's innovation succeeded in reorganizing a massive asbestos-laden business. And there were other businesses (and the entire civil litigation system) struggling with tens of thousands of asbestos claims.[91]

Codifying Manville. So, in 1994, Congress added § 524(g) to the Bankruptcy Code. The section mirrored Manville's innovation[92] and thus had the benefit of making Manville Model reorganizations clearly legal for asbestos bankruptcies.[93] It also retroactively blessed Manville and other asbestos bankruptcies that had relied on a channeling injunction.[94] By resolving that uncertainty for past Manville Model bankruptcies and authorizing the Manville Model going forward, Congress removed a weight

89. *In re* Johns-Manville Corp., 36 B.R. 743, 744, 758–59 (Bankr. S.D.N.Y. 1984). The role of this legal representative was not entirely clear, though, and early on, Judge Lifland suggested a variety of options, such as having the representative act as a guardian ad litem, amicus, or examiner. *Id.*

90. *See generally* Kenneth Ayotte & Yair Listokin, *Optimal Trust Design in Mass Tort Bankruptcy*, 7 AM. L. & ECON. REV. 403 (2005) (addressing the future-claimants question); Frederick Tung, *Taking Future Claims Seriously: Future Claims and Successor Liability in Bankruptcy*, 49 CASE W. RSRV. L. REV. 435 (1999) (same); Thomas A. Smith, *A Capital Markets Approach to Mass Tort Bankruptcy*, 104 YALE L.J. 367 (1994) (same); Mark J. Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846 (1984) (same).

91. JUDICIAL CONFERENCE REPORT, *supra* note 42, at 7–10.

92. 140 CONG. REC. 27,692 (1994).

93. 11 U.S.C. § 524(g)(1)(B), (g)(2)(B)(i).

94. 11 U.S.C. § 524(h).

from the shoulders of reorganizing asbestos businesses, paving the way for smoother asbestos bankruptcies that served both the business (which could operate without the looming tort claims) and the tort victims (who received the extra value of the business's smooth operation).[95]

To codify the Manville Model, § 524(g) explicitly authorizes bankruptcy courts to enter channeling injunctions[96] and third-party releases[97] in connection with a plan that resolved asbestos liabilities by creating a trust. The section was limited to bankruptcies based on asbestos liabilities and in which a trust would contain personal-injury actions based on those liabilities.[98]

Addressing Futures Claims. Congress also provided more precision for protecting future claims. For one, the statute requires a court to find that future claims would be paid "in substantially the same manner" as present claims before approving a § 524(g) plan.[99] That prevents present claimants from consuming all of the assets. So too Congress provides for a legal representative for future claimants, though the statute does little beyond that to flesh out the role.[100]

Protecting Tort Victims. In the same vein, Congress requires a supermajority vote of tort claimants—75%—to ensure the plan in fact serves them.[101] So too Congress requires that the plan give tort claimants stock in the reorganized SuccessorCorp.[102] Both of those mechanisms ensure that tort victims would not be given short shrift in the plan and that they would themselves benefit from the value added by the reorganization.

Outcomes. Section 524(g) proved popular and effective. During the decade after its passage, forty-four asbestos bankruptcies relied on the

95. Brown, *supra* note 53, at 854–55 (quoting 140 CONG. REC. 28,358 (1994) (statement of Sen. Howell Heflin)); 140 CONG. REC. 28,358 (1994) (statement of Sen. Hank Brown); *see* McGovern, *supra* note 16, at 242 (discussing capital markets valuing the bankruptcy).

96. 11 U.S.C. § 524(g)(1)(A), (g)(2)(B).

97. *Id.* § 524(g)(4)(A)(ii).

98. *Id.* § 524(g)(2)(B)(i)(I).

99. *Id.* § 524(g)(2)(B)(ii)(V).

100. *See id.* § 524(g)(4)(B)(i) (requiring a legal representative in cases where an injunction would extend to future claims).

101. *Id.* § 524(g)(2)(B)(ii)(IV)(bb).

102. *See id.* § 524(g)(2)(B)(i)(II) (funding the tort trust "in whole or in part" with securities). Section 524(g)(2)(B)(i)(III) gives the tort victims a majority of the stock but does not mandate that the corporation whose stock they own have any assets or value, leaving room for gamesmanship of the type seen in the Texas Two-Step, where shares in LiabilityCo do not help the tort victims protect their interests. *See id.* § 524(g)(2)(B)(i)(III) (lacking a requirement that the corporation retains its investment value).

section to effect a reorganization.[103] By 2018, that number was 120.[104] And by 2011, some $36.8 billion were held in tort trusts for the benefit of tort victims.[105] What resulted were bankruptcies that preserved more value of SuccessorCorps and, in so doing, assured further payment for tort victims.[106]

2. *Ongoing Problems*.—Section 524(g) did much good. It enshrined the legality of Manville Model tort trusts, afforded heightened protections to tort victims, and formalized representation for future claimants. At the same time, it left various problems festering in mass-tort bankruptcy.

To begin, the section is, by its terms, limited to asbestos bankruptcies.[107] That makes sense given asbestos's latency period, the need for future claims representation, and the distinct economic challenge that was fore of mind in 1994. But it also precludes the benefits of such bankruptcy for mass torts that could use them, like Dow Corning Corporation's bankruptcy, which owed to mass-tort liability related to its silicone breast implants.[108]

So too § 524(g) did little to speed up the bankruptcy process. Writing in 2003, Francis McGovern—who held a court-appointed position in many of the major § 524(g) cases—wrote that the typical plan took four to six years to confirm.[109] All the while, the business remains in limbo and value slips away.[110]

And once a plan is confirmed, § 524(g) has little to add on administration. Indeed, the section protects against underfunding only nominally, requiring a judge to find "reasonable assurance" that the tort trust will be able to pay future claims in "substantially the same manner" as comparable present claims.[111] It is silent on the administration, leaving the trust to its own devices when it comes to classifying injuries, finding experts, determining the payouts, and the like. Nor does the section speak to multiple recoveries, which led to some tort victims' double-dipping, that is,

103. *See* CARROLL ET AL., *supra* note 15, at 151–55 (listing asbestos-related bankruptcy filings from 1982 to 2004).

104. *See* Mark A. Behrens, *Asbestos Trust Transparency*, 87 FORDHAM L. REV. 107, 111 (2018) ("Over 120 companies have declared bankruptcy due, at least in part, to asbestos-related liabilities.").

105. *Id.* at 111–12 & 112 n.27.

106. 140 CONG. REC. 28,358 (1994) (statement of Sen. Howell Heflin).

107. 11 U.S.C. § 524(g)(2)(B)(i)(I).

108. *Dow Corning Emerges from Bankruptcy*, NBC NEWS (June 1, 2004, 8:42 AM), https://www.nbcnews.com/id/wbna5111436 [https://perma.cc/YKG4-W987].

109. McGovern, *supra* note 95, at 233, 242; *see* Green et al., *supra* note 45, at 730 (noting a typical timeline of five to six years); CARROLL ET AL., *supra* note 15, at 118 (noting an average of six years for the eleven major bankruptcies).

110. *Cf.* Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 865 (2014) (noting Chrysler lost $100 million per day during its Chapter 11 bankruptcy).

111. 11 U.S.C. § 524(g)(2)(B)(ii)(V).

recovering from multiple asbestos trusts for their injuries and, in turn, depriving other tort victims of a full recovery.[112]

C. *Prepackaged Manville Models*

1. The Rise of Asbestos Prepacks.—With § 524(g) in place, bankruptcy lawyers went about designing asbestos bankruptcies before filing them. That meant negotiating with creditors, reaching a plan, soliciting votes on that plan, and only then filing for bankruptcy. Essentially, this strategy of "prepackaged" asbestos bankruptcy amounted to doing the work of bankruptcy beforehand and filing only to receive the bankruptcy court's stamp of approval for any restructuring matters that required it.

And though these prepackaged bankruptcies would seem to have things backward, the Bankruptcy Code itself does contemplate them. Section 1121(a) allows the debtor to "file a plan with a petition commencing a voluntary case[.]"[113] So too §§ 1125(g) and 1126(b) permit the debtor to solicit votes on that plan before filing.[114] All these sections were written with prepackaged bankruptcy in mind.[115]

Nor were asbestos debtors the only ones to take advantage of the ability to prepackage their bankruptcies. Throughout the 1990s, debtors in all industries took advantage of the prepackaged route—by 2009, around one-third of bankruptcies each year were either prepackaged or prearranged (negotiated in advance but without a vote).[116]

Its main benefit: speed. A typical prepackaged bankruptcy takes a few months,[117] and some are as quick as one day.[118] And the asbestos cases were no different, registering only a handful of months in bankruptcy before a plan could be confirmed.[119] That, in turn, saves significant costs from the bankruptcy proceeding itself.

112. Behrens, *supra* note 104, at 110–11.

113. 11 U.S.C. § 1121(a).

114. 11 U.S.C. §§ 1125(g), 1126(b).

115. AM. BANKR. INST., A PRACTITIONER'S GUIDE TO PREPACKAGED BANKRUPTCY: A PRIMER 25–29 (Steven C. Krause ed., 2011).

116. Douglas G. Baird, *Chapter 11's Expanding Universe*, 87 TEMPLE L. REV. 975, 978 (2015).

117. *See* Douglas G. Baird, *Bankruptcy's Quiet Revolution*, 91 AM. BANKR. L.J. 593, 603–04 (2017) (discussing the speed of a prearranged bankruptcy); Jonathan C. Lipson & Christopher Fiore Marotta, *Examining Success*, 90 AM. BANKR. L.J. 1, 16 (2016) (noting that a prepackaged case averages six months in bankruptcy with a median of four months in bankruptcy).

118. *See* Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247, 248–49 (2022) (critiquing the twenty-four-hour bankruptcy of Belk, Inc.).

119. McGovern, *supra* note 95, at 260; *see* CARROLL ET AL., *supra* note 15, at 119–20 (registering three to six months).

2. *Ongoing Problems*.—At the same time, the speed of prepackaged asbestos bankruptcy brought some risks for tort victims, largely due to the lack of court oversight of the negotiation process. Among these were the issues of future claimants, lawyers' incentives, and the defendants' interest in settling for as little as possible.

In a § 524(g) bankruptcy, there must be a future claims representative.[120] But in a prepackaged bankruptcy, the court has no involvement in or oversight of the negotiations. As a result, the debtor-to-be hires a future claims representative and then negotiates with that very representative. That dynamic lends itself to a future claims representative failing to adequately bargain for the claimants she represents.[121]

A similar issue arises from the negotiations with plaintiffs' lawyers who represent the current claims. Because negotiations take place outside of the bankruptcy court, lawyers with large inventories of claims can shape the negotiation.[122] That comes at the expense of the tort victims represented by other lawyers and, especially, those future tort victims who are not represented (or are represented nominally by the future claims representative).

This negotiating dynamic is worsened by the debtor's interest in paying as little as possible. That means the debtor has every reason to underfund the tort victims' trust and to buy off the major plaintiffs' lawyers with a handsome fee to do so.[123] So too it gives the debtor every reason to hire a pliable future claims representative. And that is all true even when the business is insolvent and therefore may consider the interests of creditors and not just shareholders.[124]

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120. 11 U.S.C. § 524(g)(4)(B)(i).

121. *See* Mark D. Plevin, Robert T. Ebert & Leslie A. Epley, *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. TEX. L. REV. 883, 916–19 (2003) (noting the limited information of the future claims representative and how the debtor pays her salary). For a response to these concerns and a rosier view of future claims representatives, see Green et al., *supra* note 45, at 751–55.

122. *See* Plevin et al., *supra* note 121, at 907 (noting the district court in *Combustion Engineering* acknowledged that the main plan objection was the buying off of plaintiff's lawyers at the expense of future claimants); Barliant et al., *supra* note 51, at 453–54 (explaining that similarly situated creditors are afforded the right to not be discriminated against in the creation of the plan); Todd R. Snyder & Deanne C. Siemer, *Asbestos Pre-Packaged Bankruptcies: Apply the Brakes Carefully and Retain Flexibility for Debtors*, 13 AM. BANKR. INST. L. REV. 801, 802 (2005) (discussing plaintiff-lawyer–debtor collusion); Brown, *supra* note 53, at 861–62 (explaining that recent bankruptcies were driven by one to two controlling firms who "enjoyed largely unchecked control over key settlement terms").

123. *Cf.* Ortiz v. Fibreboard Corp., 527 U.S. 815, 852 (1999) (noting a similar dynamic in class actions over asbestos liability). The negotiating dynamic replicates itself in bankruptcy. By way of example, Joe Rice, a leading plaintiffs' attorney, received a $20 million success fee for his role in negotiations in *Combustion Engineering*, and both he and another plaintiffs' attorney received $1 million for their efforts under the *Congoleum* plan. Barliant et al., *supra* note 51, at 468.

124. Quadrant Structured Prods. Co. v. Vertin, 115 A.3d 535, 545 & n.5 (Del. Ch. 2015).

The lack of court oversight compounds these challenges. By the time negotiations have concluded, votes have been cast, and a petition has been filed, the bankruptcy judge faces significant pressure. The overwhelming consensus at that point favors the plan, however poor it is, and that creates a sense of inevitability. The judge also has little window into the assets, the appropriate amount of funding, and the negotiation process itself. That can potentially create a world where a misbegotten bankruptcy process shortchanges tort victims and the judge has little ability to nix the deal.

These pathologies were on display in high-profile prepackaged cases. Take, for example, the J.T. Thorpe bankruptcy.

Thorpe filed a prepackaged § 524(g) bankruptcy on October 1, 2002, and had judicial approval for its plan by December 18, 2002.[125] To achieve that plan, though, Thorpe negotiated with *some* of the plaintiffs' attorneys in advance of the filing.[126] No future claims representative was appointed until the bulk of Thorpe's assets had already been placed in trusts for the major plaintiffs' attorneys' clients.[127] The result was a plan that favored present tort victims over future tort victims and those represented by lawyers with large inventories of claims over those represented by smaller outfits.[128]

Nor was Thorpe unique. In both *In re Combustion Engineering, Inc.*[129] and *In re Congoleum Corp.*,[130] the debtor paid a "success fee" to high-profile plaintiffs' attorneys, who represented many claimants, to reach a global settlement.[131] That likewise led to the debtor and the attorneys trading off future-claimant interests (along with present claimants represented by other lawyers) for their clients' interests. So too in *In re ACandS, Inc.*,[132] where

125. Plevin et al., *supra* note 121, at 892–93.

126. *Id.* at 892–94.

127. Mark D. Plevin, Leslie A. Epley & Clifton S. Elgarten, *The Future Claims Representative in Prepackaged Asbestos Bankruptcies: Conflicts of Interest, Strange Alliances, and Unfamiliar Duties for Burdened Bankruptcy Courts*, 62 N.Y.U. ANN. SURV. AM. L. 271, 293 n.106 (2006).

128. *See* Plevin et al., *supra* note 121, at 893–95 (describing a two-tiered structure that favored certain claimants). The details are a bit complicated, but the plan essentially relies on the debtor settling with favored plaintiffs before bankruptcy and giving them, through that settlement, a secured claim equal to 75% of the settlement value and an unsecured claim for the other 25% of the settlement value. *Id.* at 895. Thus, in the bankruptcy, 75% of the claim was secured and would be paid at 100 cents on the dollar so long as the plan was confirmed. That unimpairment, though, did not allow the favored claimants to vote on the plan, as only impaired classes vote. 11 U.S.C. § 1126(f). But, because those same favored claimants held a 25% unsecured claim, which would be paid cents on the dollar, they could vote as part of the unsecured class and would still have the same overwhelming incentive to vote to confirm, which they did. Plevin et al., *supra* note 121, at 896. Such a maneuver has been held to violate the good faith requirement for other Chapter 11 plans. *E.g.*, *In re* Quigley Co., 437 B.R. 102, 127–29 (Bankr. S.D.N.Y. 2010).

129. 391 F.3d 190 (3d Cir. 2004).

130. 426 F.3d 675 (3d Cir. 2005).

131. Barliant et al., *supra* note 51, at 468; Pamela K. Bookman & David L. Noll, *Ad Hoc Procedure*, 92 N.Y.U. L. REV. 767, 808–09 (2017).

132. 311 B.R. 36 (Bankr. D. Del. 2004).

the judge denied plan confirmation, noting that the plan "was largely drafted by and for the benefit of the prepetition committee" and "[n]ot only . . . discriminate[s] between present and future claims, it pays similar claims in a totally disparate manner."[133] Thus, while the era of prepackaged asbestos bankruptcy did achieve the benefits of speed, to add to the benefits of the original Manville Model, it brought new downsides because of the negotiating dynamic and minimal court oversight.

D. The Texas Two-Step

The latest development in designer bankruptcy, the Texas Two-Step, pushes the prepackaged Manville Models one step further, recreating the same corporate mitosis outside of bankruptcy. In the Two-Step, a mass-tort defendant splits off its liabilities into a special-purpose entity and has the newly formed legal entity file for bankruptcy.[134] Meanwhile, the rest of the business remains outside of bankruptcy the entire time.

1. The Legal Maneuver.—Conceptually, then, the Two-Step shifts a Manville-style maneuver before bankruptcy, leaving the SuccessorCorp outside of bankruptcy altogether. From a legal perspective, this is how the Two-Step is constructed. Start with a legacy company (LegacyCo) (the equivalent of AsbestosCorp[135] in the Manville Model) that incurs mass-tort liability and has various business assets corresponding to those liabilities.

The first step for LegacyCo is to conduct a divisional merger, typically under Texas law. That divisional merger allows a business organization to divide in two, allocating assets and liabilities as it pleases across the two new entities.[136] LegacyCo uses the divisional merger to allocate all mass-tort liabilities into the newly formed LiabilityCo and everything else (ordinary business liabilities and all assets) into AssetCo.

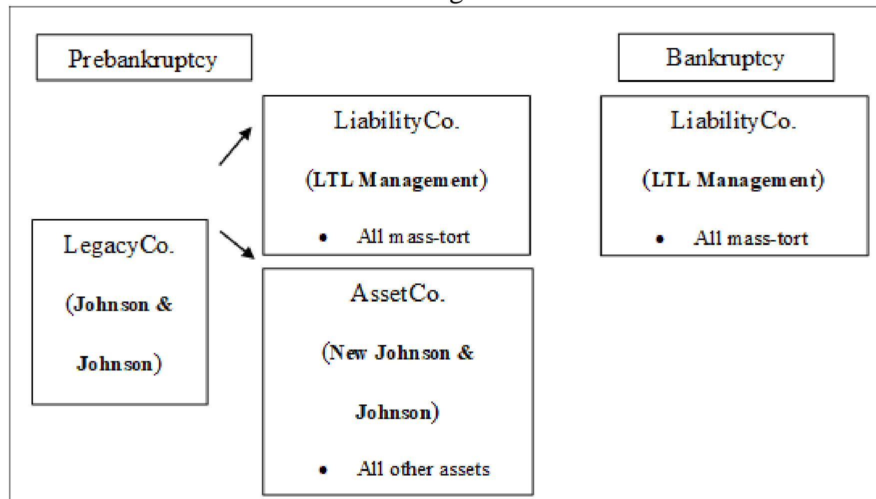
133. *Id.* at 42–43.

134. *See generally* Todd R. Snyder & Deanne C. Siemer, *The Patronus Technique: A Practical Proposal for Asbestos-Driven Bankruptcies*, 11 J. BANKR. L. & PRAC. 357 (2002) (discussing an early proposal in this direction for asbestos bankruptcies). The main difference between the "Patronus Technique" and the Texas Two-Step is that the former works on a prepackaged model and anticipates negotiation followed by a § 524(g) filing. *See id.* at 371–76 (describing the proposed technique). By contrast, negotiations in the Two-Step happen after filing and the Two-Step need not be limited to asbestos bankruptcies. *See infra* section I(D)(1).

135. *See supra* Figure 1.

136. TEX. BUS. ORGS. ANN. § 1.002(55)(A) (West 2022); TEX. BUS. ORGS. ANN. § 10.003 (West 2006).

Figure 2



To ensure that the maneuver does not run afoul of either Texas[137] or federal fraudulent transfer law,[138] the two new companies will enter into a funding agreement, which promises that AssetCo will pay LiabilityCo such amounts as a court requires under bankruptcy law.[139] LiabilityCo and AssetCo, through the funding agreement, will also indemnify one another.[140] After that, LiabilityCo will file for bankruptcy. And AssetCo will carry on the same business operations of the now-defunct LegacyCo.

The result of these maneuvers is similar to the Manville Model. For starters, the automatic stay in bankruptcy prevents tort creditors from suing LiabilityCo.[141] But a court will also enter an injunction against tort creditors suing AssetCo because the indemnification agreement means that any suit against AssetCo will be paid by LiabilityCo and thus diminishes the assets available to LiabilityCo in its bankruptcy.[142] Together, these provisions

137. Texas law forbids divisional mergers that perpetrate a fraudulent transfer against creditors. TEX. BUS. ORGS. ANN. § 10.901 (West 2006); TEX. BUS. & COM. ANN § 24.005 (West 2023). The merger itself was likely designed for tax planning and thus includes such a provision to ensure that the tax benefits do not open opportunities for cheating creditors. *See* Steven A. Bank, *Taxing Divisive and Disregarded Mergers*, 34 GA. L. REV. 1523, 1524, 1529–31 (2000) (suggesting the motivation for the Texas merger statute was to attract corporations to the state).

138. 11 U.S.C. § 548.

139. *See, e.g.*, Declaration of John K. Kim at 41, *In re* LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021), ECF No. 5 (detailing one such funding agreement).

140. *E.g.*, *id.* at 40.

141. 11 U.S.C. § 362.

142. *E.g.*, *In re* DBMP LLC, No. 20-30080, 2021 WL 3552350, at *12–13 (Bankr. W.D.N.C. Aug. 11, 2021); *In re* Aldrich Pump LLC, No. 20-30608, 2021 WL 3729335, at *12–16 (Bankr.

operate as a channeling injunction, forcing tort claimants to go to the bankruptcy court and recover from LiabilityCo alone. Conversely, regular business creditors of AssetCo will avoid LiabilityCo altogether as their debts (and assets backing them) remain inside AssetCo, which itself remains outside of bankruptcy.

2. *Improvements on the Manville Model*.—The Two-Step adds to many of the advantages of the Manville Model. Beyond the benefit of keeping productive assets in a distinct SuccessorCorp that can operate normally (without tort creditor interference), the Two-Step ensures that operational assets never enter bankruptcy to begin with.[143] So those assets remain beyond the interference of the creditors and beyond the burdens imposed by bankruptcy law.

In turn, that reduces the costs of operating AssetCo, saving money for the tort victims, which they receive through the funding agreement. Likewise, the bankruptcy of LiabilityCo itself becomes less costly because there is little to wrangle about for the reorganization—LiabilityCo does not operate a business and thus the bankruptcy does not drag on for years negotiating over that reorganization.

Also, unlike a prepackaged § 524(g) bankruptcy, there are no skewed negotiations.[144] The funding agreement specifies that AssetCo will pay the full value to which bankruptcy entitles tort victims in LiabilityCo's bankruptcy.[145] So select plaintiffs' lawyers cannot cut a favorable deal with AssetCo and freeze out either future claimants or present claimants who picked the wrong lawyers. In fact, the future claims representative will be appointed by the court and will be present for the entirety of negotiations—all of which happen inside the bankruptcy, unlike in a prepackaged bankruptcy.[146]

Finally, the Two-Step need not be limited to asbestos. While the major cases so far have involved suits against companies for asbestos—DBMP, Bestwall[147]—nothing about the maneuver requires as much. Indeed, 3M initiated a copycat maneuver, relying on the same mutual indemnification

W.D.N.C. Aug. 23, 2021); *In re* Bestwall LLC, 606 B.R. 243, 254–58 (Bankr. W.D.N.C. 2019). *See generally* S. ELIZABETH GIBSON, JUDICIAL MANAGEMENT OF MASS TORT BANKRUPTCY CASES (2005) (discussing the doctrine for extending a stay to nondebtor parties).

143. *See supra* section I(D)(1).

144. *See supra* section I(D)(1); section I(C)(2).

145. *See supra* section I(D)(1).

146. *See supra* subpart I(C).

147. Adam Levitin, *The Texas Two-Step: The New Fad in Fraudulent Transfers*, CREDIT SLIPS (July 19, 2021, 10:50 AM), https://www.creditslips.org/creditslips/2021/07/the-texas-two-step.html#more [perma.cc/28Y6-5KUM].

strategy to create a Two-Step to manage Aearo's liability for earplugs made for the military.[148]

3. Ongoing Problems.—At the same time, the Two-Step poses risks that attend all its benefits. These risks are tied directly to its ability to keep assets outside of bankruptcy altogether.

Underfunding. For starters, there is the risk of an inadequate funding agreement. In a Manville Model bankruptcy, the assets of the business are all in bankruptcy, at least for some amount of time.[149] But in a Two-Step, there is a risk that LegacyCo uses the maneuver to hide assets from tort victims. For example, if tort victims are owed $2 billion and the funding agreement caps their recovery at $1 billion while leaving another $4 billion of LegacyCo's assets in AssetCo, the bankruptcy gives tort victims less than they are entitled to under bankruptcy law.[150]

That extreme example is unlikely, but more subtle versions abound. Suppose the funding agreement entitles tort victims to every penny that a LegacyCo bankruptcy would yield for them. But now suppose that management of AssetCo decide to issue a dividend. Those dividends might underfund AssetCo to the point that it cannot pay all that the tort claimants are owed. To extend the previous example, the funding agreement might allot tort claimants the $2 billion they are owed, but AssetCo pushes out $4 billion in dividends, leaving only $1 billion in AssetCo. That effectively pays shareholders instead of tort victims, violating the absolute priority rule that would prevail in a LegacyCo bankruptcy.[151]

More subtle still, AssetCo might simply undertake risky projects, a typical form of the traditional debt-equity conflict. To borrow an example

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148. *See* Chris DiLella & Seema Mody, *3M Fights a Growing Legal Battle Over Combat-Grade Earplugs*, CNBC (Mar. 22, 2023, 1:59 PM), https://www.cnbc.com/2023/03/15/3m-legal-battle-combat-grade-earplugs.html [https://perma.cc/4GLS-R3BQ] (discussing 3M's liability risk). 3M did not need a divisional merger because its subsidiary, Aearo, was already a separate legal entity and housed the liability. *Id.* But 3M is relying on the same mechanism of mutual indemnification that is central to the Two-Step and thus represents the expansion of the Two-Step into non-asbestos bankruptcies. *Id.*

149. *See supra* section I(A)(2).

150. This appears to be what Johnson & Johnson attempted in its second go at LTL Management's bankruptcy. After the Third Circuit's opinion and subsequent dismissal of the bankruptcy, LTL and Johnson & Johnson reworked the funding agreement and developed a plan support agreement that would establish a trust worth $8.9 billion, which would deprive tort creditors of the potential to recover up to the prebankruptcy value of the business. *See In re* LTL Mgmt., LLC, 652 B.R. 433, 440 (Bankr. D.N.J. 2023) (explaining that Johnson & Johnson "provided for a plan of reorganization that includes the establishment of a trust funded in the amount of $8.9 billion"); *cf. In re* LTL Mgmt., LLC, 58 F.4th 738, 762 n.18 (3d Cir. 2023) (contemplating this possibility and noting that it might be a fraudulent transfer).

151. Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 9.

from Laura Lin:[152] Imagine a business with $8,000 in assets and $10,000 in liabilities. It can undertake one of two projects. The first will result in a value of $8,500 for the business. The second will, with 10% probability, result in a value of $50,000 for the business and, with 90% probability, result in a value of $200 for the business. The first project has a higher expected value ($8,500 versus $5,180). But shareholders will prefer the second because they receive no payment if the first project is undertaken, and they have the possibility of a payout if the second project is undertaken.[153]

Ordinarily, contract creditors use covenants to prevent such maneuvers.[154] In a Manville bankruptcy, the tort claimants themselves own stock, also mitigating the conflict. But here, the tort claimants own no stock in AssetCo (and never will).[155] So management in AssetCo might undertake projects that are poor bets and might result in AssetCo lacking the assets to back the funding agreement (even if, when LiabilityCo entered bankruptcy, AssetCo had enough assets to pay it).

Loyalty. Worse yet, management are unlikely to protect tort victims. For starters, management of AssetCo owe a duty to their shareholders. In cases of uncertain solvency, AssetCo management may consider creditors but need not do so.[156] And even if AssetCo is insolvent, creditors will have a difficult time challenging management's decisions given the business judgment rule.[157]

LiabilityCo's management will all be installed by LegacyCo in the divisional merger. That means their loyalties will lie with shareholders of LegacyCo. By way of example, in Johnson & Johnson's Two-Step, the

152. Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485, 1489–90 (1993).

153. *Id.* at 1489–91.

154. This fact has been critical in Delaware courts' rejection of the idea of a duty to creditors as a firm nears insolvency. *E.g.*, Prod. Res. Grp., LLC v. NCT Grp., Inc., 863 A.2d 772, 777 (Del. Ch. 2004). The courts' logic, though, is undercut in cases where debts are owed to tort victims who cannot negotiate for such covenants.

155. In a § 524(g) bankruptcy, the tort victims receive stock in reorganized LiabilityCo, which will be unhelpful for controlling AssetCo. 11 U.S.C. § 524(g)(2)(B)(i)(III).

156. For the classic statement, see *Credit Lyonnais Bank Nederland, N.V. v. Pathe Comms. Corp.*, No. 12150, 1991 WL 277613, at *34 & n.55 (Del. Ch. Dec. 30, 1991). For the development of caselaw on that view, see *Prod. Res. Grp., LLC v. NCT Gr., Inc.*, 863 A.2d 772, 798 (Del. Ch. 2004); *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, No. 1456-N, 2006 WL 2588971, at *1 (Del. Ch. Sept. 1, 2006); *Quadrant Structured Prods. Co. v. Vertin*, 115 A.3d 535, 546–47 (Del. Ch. 2015).

157. *Vertin*, 115 A.3d at 547–48, 547 n.18 (citing, among others, Shandler v. DLJ Merch. Banking, Inc., No. 4797, 2010 WL 2929654, at *14 (Del. Ch. July 26, 2010)).

management of LiabilityCo are seconded from the parent corporation and thus, quite literally, are on Johnson & Johnson's payroll.[158]

The result is that management might decline to pursue a fraudulent transfer action. They might also settle a fraudulent transfer action on the cheap, especially in more subtle cases, like a dividend, where management can plausibly argue that the dividend did not render AssetCo insolvent and thus that LiabilityCo is unlikely to prevail in litigation.[159] And because the debtor's management control such fraudulent-transfer claims, tort victims will not be able to bring those cases on their own if management fall short.[160]

Delay. All that makes the Two-Step an excellent delay tactic for mass-tort defendants. Because management, not tort victims, control the proceeding, and management can delay negotiations, refuse to bring fraudulent-transfer suits, and the like, tort victims are in a bind.[161] They often need cash imminently for medical expenses yet have no ability to sue (the automatic stay and third-party injunction bar that). And because the funding agreement conditions payment on the victims voting to confirm a plan, victims have no way to obtain payment during the pendency of the bankruptcy.[162]

Legality. Finally, the legality of the Two-Step is not entirely clear. In particular, the Two-Step relies on the court in LiabilityCo's bankruptcy entering a third-party release for AssetCo. This repeats the issue of the channeling injunction in Manville, where scholars, lawyers, and judges debated whether bankruptcy courts can lawfully order such a release.[163] Congress resolved that issue for asbestos cases in § 524(g).[164] But for other

158. *In re* LTL Mgmt., LLC, 637 B.R. 396, 404 (Bankr. D.N.J. 2022), *rev'd*, 64 F.4th 84 (3d Cir. 2023). Fiduciary duties of debtors-in-possession are also hard to litigate. *See* John A.E. Pottow, *Fiduciary Principles in Bankruptcy and Insolvency*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 205, 218–20 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019) (describing challenges posed by these fiduciary duties and doctrine favoring the debtor-in-possession).

159. *See* Jared A. Ellias, Ehud Kamar & Kobi Kastiel, *The Rise of Bankruptcy Directors*, 95 S. CAL. L. REV. 1083, 1110 (2022) ("[I]t is hard to imagine the private equity industry not noticing how bankruptcy directors can settle disputes regarding risky dividends for a fraction of the dividend amount.").

160. *In* re DBMP LLC, No. 20-30080, 2021 WL 3552350, at *18 (Bankr. W.D.N.C. Aug. 11, 2021).

161. Francus, *supra* note 7, at 43–44.

162. *E.g.*, Declaration of John K. Kim at 40, *In re* LTL Mgmt., LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021), ECF No. 5.

163. *E.g.*, Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 965; Adam J. Levitin, *The Constitutional Problem of Nondebtor Releases in Bankruptcy*, 91 FORDHAM L. REV. 429, 431–32 (2022); Thomas E. Plank, *The* Erie *Doctrine and Bankruptcy*, 79 NOTRE DAME L. REV. 633, 670–76 (2004); *see also* Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154, 1170 nn.77–78 (2022) (collecting sources on the debate).

164. *See supra* subpart I(B).

mass torts, courts across the country are split on both the legality of such releases and the standard to apply.[165]

The maneuver itself (apart from third-party releases) has also had a mixed run in court. Bankruptcy judges in the Fourth Circuit, where Two-Step cases tend to be filed,[166] have all refused to dismiss the bankruptcies.[167] But the Third Circuit, in *In re LTL Management, LLC*,[168] imposed a financial-distress requirement before mass-tort defendants can use the Two-Step, dismissing Johnson & Johnson's case.[169] Two-Steppers will either satisfy that requirement by claiming such financial distress (often legitimately, given the amount of liability looming in mass torts) or avoid it by continuing to forum shop to jurisdictions that do not impose a financial distress requirement. The result will be a combination of forum shopping[170] and uncertain legality in large, mass-tort bankruptcies.

All in all, then, the Texas Two-Step amplifies both the benefits and risks of the Manville Model. By moving the corporate mitosis before bankruptcy, the Two-Step makes business easier and preserves more value than would be lost in bankruptcy. At the same time, it also poses risks to tort victims because of the lack of oversight created by the shift to prebankruptcy mitosis.

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165. *See, e.g.*, *In re* W. Real Est. Fund, Inc., 922 F.2d 592, 601–02 (10th Cir. 1990) (barring third-party releases); *In re* Lowenschuss, 67 F.3d 1394, 1401–02 (9th Cir. 1995) (barring third-party releases); *In re* Pac. Lumber Co., 584 F.3d 229, 253 (5th Cir. 2009) (barring third-party releases except insofar as they replicate qualified immunity for creditors' committee); *In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 143 (2d Cir. 2005) ("A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan . . . ."); *In re* A.H. Robins Co., 880 F.2d 694, 702 (4th Cir. 1989) (allowing third-party release on facts of the case); *In re* Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002) (describing a seven-factor test); *In re* Ingersoll, Inc., 562 F.3d 856, 864–65 (7th Cir. 2009) (allowing third-party release on facts of the case); *In re* Seaside Eng'g & Surveying, Inc., 780 F.3d 1070, 1078–79 (11th Cir. 2015) (following Sixth Circuit's *Dow Corning* factors but treating them as a "nonexclusive list of considerations"); *In re* Millennium Lab Holdings II, LLC, 945 F.3d 126, 139–40 (3d Cir. 2019) (allowing third-party release on facts of the case). *See generally* Dorothy Coco, Note, *Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law*, 88 FORDHAM L. REV. 231 (2019) (describing current doctrine and circuit splits).

166. For an explanation of this use of forum shopping, see Francus, *supra* note 7, at 42 n.25, 47.

167. *E.g.*, *In re* DBMP LLC, No. 20-30080, 2021 WL 3552350, at *37 & n.245 (Bankr. W.D.N.C. Aug. 11, 2021).

168. 64 F.4th 84 (3d Cir. 2023).

169. *Id.* at 101–02, 110–11.

170. *See* Anthony J. Casey & Joshua C. Macey, *Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars*, 37 EMORY BANKR. DEVS. J. 463, 478–79 (2021) (noting that "liberal venue rules make [forum shopping] especially easy for bankruptcy cases").

II. A Theoretical Framework: Organizational Law, Bankruptcy Law, and Mass Torts

The designer bankruptcies described above all rely on the interaction of corporate structure and bankruptcy law. In doing so, they get at bankruptcy's most fundamental questions—which assets and liabilities are contained in which legal entities, which of those entities are subject to bankruptcy's legal regime, and how those entities are governed.

Each of these questions is known from organizational law, which explores the law surrounding legal entities like corporations, trusts, and other legal persons. Respectively, these are the questions of asset partitions, regulatory partitions, and governance. This Part places the iterations of mass-tort bankruptcy—the Manville Model and the Texas Two-Step—into an organizational law framework. In so doing, it shows how the benefits and dangers of each framework fit into well-understood categories and points the way to understanding how bankruptcy can offer the best of both worlds: maximizing the value of the mass-tort business and ensuring that tort victims receive every penny bankruptcy law entitles them to.[171]

A. *Asset Partitioning*

1. The Fundamentals of Asset Partitions.—The essential role of a legal entity is asset partitioning, that is, defining which assets belong to the entity and which to its owners.[172] That partition, in turn, defines which assets creditors of the entity (or the owners) can access.

The simplicity of those asset partitions belies their importance. By defining assets of a legal entity, creditors of that entity can know which assets to monitor and which assets they can recover if the entity does not, for example, perform its contracts. And those benefits can be directly tied to the rise of the modern firm.[173]

To take the classic example, imagine a business that operates both a chain of hotels and an oil refinery.[174] The business can either keep both lines of business in one corporation or it can incorporate the hotel business and the

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171. A properly designed Texas Two-Step does not weaken deterrence against businesses for committing torts. The reason for that is that a properly designed Texas Two-Step adds value to a debtor business but ensures that any value goes to the tort victims until they are paid in full. Thus, shareholders do not receive any extra value created by using a Two-Step (instead of a class action or ordinary bankruptcy), tort victims do. In turn, the existence of the Two-Step as a legal option—if designed properly—does not weaken deterrence.

172. *See* Hansmann & Kraakman, *supra* note 27, at 390 (arguing that "the essential role of all forms of organizational law is to provide for . . . a form of 'asset partitioning'").

173. *See* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1336–37 (2006) (tracing the historical roots of entity shielding as a form of asset partitioning and its effect on modern firms).

174. Hansmann & Kraakman, *supra* note 27, at 399.

refinery separately. Typically, it makes sense to incorporate separately because the businesses rely on different creditors. The hotel business creditors know little about oil refineries. So it is easy for them to monitor the hotel business and understand the likely fortunes of the hotel business. Not so for the refinery, though, where hotel creditors have little knowledge. Hence, separately incorporating the two businesses relieves the hotel creditors of worrying about the oil business and, in turn, allows those creditors to extend credit to the hotel business on better terms.[175]

Another key benefit of asset partitioning lies in its ability to cure a debt overhang. Businesses with high debt (like mass-tort debt) often struggle to raise capital, even for valuable projects. To borrow an example from Mark Roe, imagine a firm worth $2 billion but owing $5 billion in future debt.[176] Equity financing is unattractive because stockholders recover after creditors, meaning that new stockholders' money will likely end up in the hands of preexisting creditors.[177] Likewise, new unsecured creditors will worry that their loans will be used to pay preexisting claims and, thus the new investment will not be repaid.[178]

Yet creating a new corporation can solve this problem. A new corporation will have no debt when formed, and thus new equity and new credit need not worry about the preexisting debt of a parent business.[179]

These benefits of asset partitioning—lowering monitoring costs and curing debt overhang—give potential creditors reasons to lend to a business that takes advantage of asset partitioning. In turn, that facilitates investment, which has led to the rise of modern, large-scale business enterprises.[180]

2. Designer Bankruptcy as Asset Partitioning.—All of the iterations of designer bankruptcies undertake some form of asset partitioning. The Manville bankruptcy, for example, created a successor corporation whose assets could not be reached by asbestos creditors but were available to other creditors, like employees, lenders, and suppliers.[181] At the same time, the Manville Trust's beneficiaries were tort victims and thus the assets of the Trust could only be accessed by those tort victims.[182] Therefore, the Manville Model partitions asbestos liabilities and assets to compensate victims into

175. *Id.* at 400.

176. Roe, *supra* note 90, at 856.

177. *Id.*

178. *Id.*

179. Henry Hansmann & Richard Squire, *External and Internal Asset Partitioning: Corporations and Their Subsidiaries*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 251, 257 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2016).

180. *See* Hansmann et al., *supra* note 173, at 1336 (noting the deep roots of asset partitioning in Western commercial law).

181. *See supra* subpart I(A).

182. *See supra* subpart I(A).

one pool (tort trust) and the remaining liabilities and the business's operational assets into another pool (SuccessorCorp).[183]

The § 524(g) and prepackaged bankruptcies that followed did the same, as they are statutory versions of the same Manville Model. In both, a SuccessorCorp and a tort trust are created through the process of bankruptcy.[184] The trust's beneficiaries are the tort victims, for whom a pool of assets is partitioned.[185] And the channeling injunction ensures that the tort victims can access only the assets of the trust—not the successor corporation. That leaves other creditors with a defined pool of assets, namely, the successor corporation (and not the trust), that they alone (and not tort creditors) can reach.

So too the Texas Two-Step partitions assets. Tort victims, and only tort victims, may access the asset that is the funding agreement.[186] That is so because the tort creditors are creditors of LiabilityCo and LiabilityCo alone benefits from the funding agreement. Conversely, tort creditors may not reach the assets of AssetCo thanks to the bankruptcy court's injunction. Those assets, instead, may be accessed by AssetCo's creditors and only them. In short, then, the Two-Step partitions the funding agreement and tort liability into one asset pool (LiabilityCo) and the remaining assets and liabilities into another asset pool (AssetCo).

Key, though, is that the Texas Two-Step's asset partitioning is incomplete. That's so because the pools overlap—the funding agreement draws on the assets in AssetCo.[187] So business creditors of AssetCo can dip into the assets that back the funding agreement, meaning that the defined pool of assets for tort creditors (the funding agreement) is not exclusively available to tort creditors.[188] Nor do they even have priority on those assets over business creditors of AssetCo as the tort judgment and the funding agreement create no security interest.[189] Conversely, the funding agreement allocates a certain amount of AssetCo assets to the tort creditors' LiabilityCo, and thus business creditors only have some assets of AssetCo that are defined exclusively for them.[190]

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183. *See supra* subpart I(A).

184. *See supra* subparts I(B)–(C).

185. *See supra* subparts I(B)–(C).

186. *See supra* subpart I(D).

187. *See supra* subpart I(D).

188. There will be some complete asset partitioning because LiabilityCo often receives some hard assets beyond the funding agreement. *E.g.*, Declaration of John K. Kim at 6, *In re* LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021), ECF No. 5. Those assets are within LiabilityCo and thus unavailable to business creditors of AssetCo, achieving a complete partition. But they are a relatively small amount of the mass-tort liability and exist to fund the costs of the bankruptcy, not to compensate victims. *Id.* at 39–40.

189. *See supra* subpart I(D).

190. *See supra* subpart I(D).

All this holds until the end of the bankruptcy. At that point, a plan will define the assets for LiabilityCo and for AssetCo, presumably requiring that the plan for LiabilityCo result in hard assets to be distributed to victims.[191] Once that happens, complete asset partitioning would be achieved and overlapping claims on the same assets would be eliminated.

3. Benefits of Bankruptcy's Asset Partitioning.—In principle, this bankruptcy form of asset partitioning promises the same benefits as ordinary asset partitioning. This is true for a Manville Model in all situations and for a Texas Two-Step that confirms a plan in which the funding agreement is replaced by assets placed in AssetCo, thus achieving a complete asset partition.

Take the example of Manville's partition. Would-be creditors of SuccessorCorp need not concern themselves with the business's tort liability and can instead invest based on the value of the assets, monitor those assets, and be confident about which assets they can recover should the business fail. That results in lower monitoring costs, as traditional asset partitioning yields. And it can cure the debt overhang caused by tort liability, just as traditional asset partitioning can.

Likewise, tort victims have certainty. The tort victims know that only they will have access to the tort trust assets. So they need not fret that the cash in the trust will be used to pay non-tort creditors.[192]

All in all, then, designer bankruptcy's asset partition cures a debt overhang through the Manville Model or a properly designed Two-Step plan. Both also reduce the monitoring costs for non-tort creditors who interact with SuccessorCorp or AssetCo. And both limit the monitoring costs for tort creditors, who no longer need to worry about the business operations of SuccessorCorp or AssetCo.

And by curing the debt overhang, either designer-bankruptcy maneuver yields extra investment in SuccessorCorp or AssetCo that benefits the tort victims. Because a Manville trust includes stock in the successor corporation, an increase in the value of the successor corporation increases the assets

191. *See supra* subpart I(D). In theory, the court could confirm a plan that kept the funding agreement in place rather than completing the asset partition. But it seems unlikely that a debtor would propose such a plan as it does not achieve the benefits of asset partitioning—lower monitoring costs and curing debt overhang—as the business creditors must continue worrying about the tort debt drawing on AssetCo assets via the funding agreement.

192. Because the Manville Model requires that the tort trust own stock in SuccessorCorp, the tort creditors (through the trust) will have to do some monitoring of SuccessorCorp. So the monitoring costs do not disappear altogether unless the trust chooses to sell the stock. But the monitoring costs of *shareholders* in keeping tabs on management are not those that asset-partitioning concerns aim to minimize. *See* Hansmann & Kraakman, *supra* note 27, at 399–400 (using an example to discuss monitoring costs).

available for tort victims to recover.[193] Likewise, for a Texas Two-Step the funding agreement allocates increased value of AssetCo to the tort victims.[194] So the benefits of the asset partition (monitoring, curing debt overhang) accrue to the benefit of both the business and the tort victims.

4. The Role of Bankruptcy.—What is the role of bankruptcy in all this? After all, these maneuvers are not primarily bankruptcy maneuvers. Asset partitioning does not rely on eliminating prior debt (bankruptcy's discharge) or restructuring business operations under court supervision (bankruptcy's reorganization plan). The maneuvers reshuffle assets and liabilities, using bankruptcy's stay and injunctions to do so instead of corporate law. The answer: Bankruptcy's traditional roles make it well-equipped to do both *ex ante* and *ex post* partitioning.

Ordinary asset partitioning happens *ex ante* through corporate law. The corporation sets up a subsidiary for the hotel and a separate subsidiary for the refinery *before* investors decide to invest.[195] Indeed, that is how the business captures the benefits of asset partitioning—saving hotel creditors the costs of monitoring the refinery and vice versa.

But *ex post* asset partitions do not really work, at least in cases of insolvency. Once the corporation has incurred liability, it cannot simply invalidate the liability. Nor can it move assets to avoid paying that liability; fraudulent transfer law undercuts such maneuvers.[196] By way of example, if the business initially houses the hotel and the refinery in the same corporate entity and then the hotel business flops, the corporation cannot then incorporate the refinery and hotel separately, leaving the hotel insolvent while the refinery continues to turn a profit with assets that once belonged to the legacy corporation.[197] Even if the spinoff involved a funding agreement, hotel creditors would (at least indirectly) have access to the same pool of assets as the refinery creditors, undercutting any asset partition.[198]

But bankruptcy law is well-equipped to conduct that asset partitioning. Bankruptcy always acts *ex post* (the liability has been incurred), and it always defines which creditors receive which assets. Bankruptcy, by design, addresses competing claims to the same assets and thus determines who owns

193. *See supra* subparts I(A)–(C).

194. *E.g.*, Declaration of John K. Kim at 40, *In re* LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021), ECF No. 5.

195. Hansmann & Kraakman, *supra* note 27, at 399–401.

196. 11 U.S.C. § 548.

197. *See id.* § 548(a)(1)(A) (invalidating transfers intended to "hinder, delay, or defraud" a creditor).

198. *See supra* subpart I(D). This type of funding agreement would thus be an incomplete asset partition in the Texas Two-Step.

assets.[199] That requires it to have certain tools: a stay[200] to prevent creditors who are not entitled to assets from obtaining them; injunctions[201] to prevent creditors who are not stayed from obtaining assets they are not entitled to; a discharge[202] to prevent creditors from obtaining post-bankruptcy assets that they are not entitled to; and the ability to redefine property rights through a plan of reorganization.

Together, these tools are not typically used for asset partitioning. A Chapter 11 plan typically reorganizes one business and reconfigures property rights to its pool of assets rather than creating multiple pools of assets.[203]

But those same tools are also well-suited for asset partitioning. Between the automatic stay, third-party injunctions, channeling injunctions, and a discharge, bankruptcy can ensure that tort victims cannot access the successor corporation's assets or AssetCo's assets while business creditors can. Conversely, those tools, along with a § 524(g) trust, can ensure that business creditors cannot access the tort victims' assets.[204]

At the same time, that *ex post* asset partition is also an *ex ante* partition for the successor corporation. That successor corporation (or AssetCo) will continue to operate and need lenders, employees, and vendors. All of those will be more willing to extend future credit once the trust or LiabilityCo exists and the asset pools of the two legal entities (SuccessorCorp and tort trust or AssetCo and LiabilityCo) are clearly defined.

So bankruptcy proves an able mechanism for achieving asset partitioning *ex post* when it would be impossible through other legal mechanisms. And that is true even though such asset partitioning is not the core role of bankruptcy law.

199. *See* Marcus Cole, *Limiting Liability Through Bankruptcy*, 70 U. CIN. L. REV. 1245, 1252–54 (2002) (explaining that an essential function of bankruptcy is its temporal partition, which determines ownership of an asset across time).

200. 11 U.S.C. § 362.

201. *See, e.g.*, *In re* DBMP LLC, No. 20-30080, 2021 WL 3552350, at *38–43 (Bankr. W.D.N.C. Aug. 11, 2021) (discussing an injunction protecting a nondebtor under 11 U.S.C. § 105); *In re* Johns-Manville Corp., 68 B.R. 618, 624–26 (Bankr. S.D.N.Y. 1986) (discussing a channeling injunction).

202. 11 U.S.C. § 1141(d)(1)(A).

203. The difference here is subtle but important. In the case of bankruptcy, the claims to the same asset mean that someone will lose. For example, the holder of a security interest in the asset will receive the asset rather than a tort claimant holding an unsecured claim against the debtor. In the case of asset partitioning, the security-interest holder and the tort claimant each have separate pools of assets that they would recover from, something that bankruptcy law does not traditionally cognize because of its focus on distributing assets based on priority of claim to the asset. *See* Richard Squire, *The Case for Symmetry in Creditors' Rights*, 118 YALE L.J. 806, 808–09 (2009) (describing the difference and arguing that bankruptcy should move to the latter).

204. 11 U.S.C. § 524(g); *see* Declaration of John K. Kim at 40, *In re* LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C. Oct. 14, 2021), ECF No. 5 (explaining that trusts were created "for the benefit of existing and future claimants" during reorganization).

B. Regulatory Partitioning

1. The Fundamentals of Regulatory Partitioning.—The second organizational-law aspect of these designer bankruptcies is regulatory partitioning, that is, keeping assets and liabilities in separate legal entities based on legal statuses attributed to those entities and, in turn, the legal regimes that regulate them.[205]

So, for example, a corporation might choose to use a separate legal entity to transform its corporate citizenship and thus obtain the benefits of investment treaties. That was the case of Tokios Tokelės UAB, a company owned by Ukrainians but incorporated in Lithuania, which used its Lithuanian corporate citizenship to invoke arbitration under the Lithuania–Ukraine bilateral investment treaty (instead of suing in Ukrainian courts, as would be standard for such a dispute).[206] More commonly, businesses operate through separate legal entities to limit the burdens of tax law.[207] In either case, though, the legal entity benefits from opting into a particular regulatory scheme (bilateral investment treaty protections) or opting out of a regulatory scheme (a more expensive tax bill).

2. Designer Bankruptcy as Regulatory Partitioning.—For designer bankruptcy, the primary regulatory partition is the bankruptcy partition—that is, which entities are subject to bankruptcy's regulatory regime and which are not.[208] Secondarily, there is a regulatory partition in the form of imposing a workers' compensation-style scheme for a particular mass tort.

Start with the bankruptcy partition. On the inside of the bankruptcy partition are creditors, both in the Manville Model and the Texas Two-Step. That is key because bankruptcy forces creditors into a collective debt-collection proceeding. Thus, creditors cannot dismember a viable business and will not be compensated on a first-come, first-served basis that beggars victims with latent injuries.

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205. Pargendler, *supra* note 29, at 719. *See generally* Pargendler, *supra* note 30 (giving a taxonomy).

206. *See* Pargendler, *supra* note 30, at 270 (using a Ukraine–Lithuania example). For another, fascinating example of opting out of a regulatory scheme, consider the United States Fleet Corporation, established to create a nongovernmental fleet so that vessels in disputes on the high seas would not accidentally result in war. GAIL RADFORD, THE RISE OF THE PUBLIC AUTHORITY: STATEBUILDING AND ECONOMIC DEVELOPMENT IN TWENTIETH-CENTURY AMERICA 22–25 (2013).

207. Pargendler, *supra* note 30, at 265.

208. *See* Douglas G. Baird, Anthony J. Casey & Randal C. Picker, *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1684 (2018) ("But the bankruptcy process does not merely partition assets. It also sorts out rights among stakeholders."); *see* Baird & Casey, *supra* note 24, at 11–12 (discussing "[t]he ability to craft withdrawal rights by putting assets of the same business in different legal entities").

As for the business's regulatory partition, bankruptcy's regulatory regime imposes significant burdens, so businesses in bankruptcy face these regulatory burdens and those outside of bankruptcy do not.

Taking advantage of this inside-versus-outside of bankruptcy partition is a distinct development of the Texas Two-Step. In the Manville bankruptcy, a § 524(g) bankruptcy, or a prepackaged bankruptcy, the entire business enters bankruptcy and is subject to bankruptcy's rules. Only later do two entities emerge. There is no division of legal entities in which one is subject to bankruptcy's regulatory regime and another is not. And though the prepackaged version limits time in bankruptcy, it still subjects the entire business to bankruptcy's regulatory regime.

But in the Two-Step, the business takes full advantage of the bankruptcy partition. AssetCo never enters bankruptcy and is thus not subject to bankruptcy's regulatory regime.[209] LiabilityCo does enter bankruptcy and thus is subject to bankruptcy's regulatory regime.[210] That achieves the regulatory partitioning common in other areas of business law, just as when one subsidiary of a corporation can avoid onerous tax laws.

As for the regulatory partition for compensation regimes, bankruptcy allows for mass torts to be addressed through a workers' compensation scheme. That happens through the creation of a new legal entity in the bankruptcy court that can be made subject to such a compensation scheme thanks to bankruptcy law. In the Manville Model, for example, the court creates a trust, and tort claimants must submit a claim to that legal entity, which operates based on a workers' compensation model imposed by the bankruptcy court.[211]

This same partitioning can be achieved in the Texas Two-Step, though we have yet to see it there. In principle, LiabilityCo can create or become a trust. And with bankruptcy court approval, the trust can impose the same type of workers' compensation scheme that a Manville trust has.

3. Benefits of Bankruptcy's Regulatory Partition.—In principle, the Two-Step's regulatory partition holds much promise. And this promise builds on the benefits that all forms of designer bankruptcy obtain from asset partitioning.

Inside the Bankruptcy Partition. Here's why. A business facing a creditor run benefits from bankruptcy's ability to coordinate creditor collection. It does so through the automatic stay and rules that determine, in

209. *See supra* subpart I(D).
210. *See supra* subpart I(D).
211. *See supra* subpart I(A).

an orderly fashion, which creditors receive what.[212] That prevents creditors from dismembering a valuable business, preserving value for business and creditors alike. So there is a benefit to having the creditors subject to a bankruptcy regime, which both the Manville Model and the Texas Two-Step achieve.

Outside the Bankruptcy Partition. On the flipside, a business facing that creditor run (or any form of financial distress) needs to reorganize. But it need not do so in bankruptcy. Out-of-court reorganizations are common.[213] And they are often preferable. Indeed, any distressed business *could* file for bankruptcy, but many use out-of-court workouts, suggesting that bankruptcy is a second-best mechanism for resolving financial distress. Largely, that owes to the out-of-court reorganization avoiding many of the costs of bankruptcy, monetary and otherwise.[214]

On the monetary side, bankruptcy requires a host of professionals. And those lawyers, consultants, turnaround specialists, and more all take their fees. Lynn LoPucki and Joseph Doherty found that in large bankruptcies (over $100 million in 1980 dollars), professional fees average 1.4% of the debtor's assets.[215] Stephen Lubben, looking at twenty-two large bankruptcies from 1994, found that these costs totaled 2.5% for traditional bankruptcies (and less for prepackaged bankruptcies).[216]

And that just accounts for the debtor's costs. As Anthony Casey and Joshua Macey point out, a Johnson & Johnson bankruptcy would sweep in hundreds of subsidiaries with creditors of each having to file a claim and the judge needing to value the claim.[217] And each of those creditors would incur legal costs as well—costs not captured in the classic studies on professional fees.

212. *See* JACKSON, *supra* note 34, at 10 ("[T]here are powerful reasons to think that there *is* a superior way to allocate the assets of an insolvent debtor than first-come, first-served.").

213. *See* Edith S. Hotchkiss, Kose John, Robert M. Mooradian & Karin S. Thorburn, *Bankruptcy and the Resolution of Financial Distress*, *in* HANDBOOK OF CORPORATE FINANCE 235, 249–52 (B. Espen Eckbo ed., 2008) (surveying data on frequency of out-of-court workouts).

214. *See* Stuart C. Gilson, Kose John & Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315, 346 (1990) (finding that "insolvent firms with relatively high going-concern value are more likely to restructure their debt privately, because more of this value tends to be lost for a variety of reasons . . . when debt and the firm's operations are reorganized in Chapter 11 [bankruptcy proceedings]").

215. Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL L. STUD. 111, 113, 115 n.13 (2004).

216. Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 511, 513 (2000).

217. Anthony J. Casey & Joshua C. Macey, *In Defense of Chapter 11 for Mass Torts*, 90 U. CHI. L. REV. 973, 988, 1008 (2023).

From the perspective of running a business, bankruptcy adds other burdens. Professional fees must be approved by the court,[218] which takes time and may deter certain professionals from working for the debtor. Transactions beyond the ordinary course likewise require court approval.[219] Creditors can, and do, object to business decisions—including key decisions like obtaining debtor-in-possession (DIP) financing so that the business has enough cash on hand.[220]

Compensation Partition. As for the workers' compensation scheme, it has much to commend it. Outside of such a scheme, tort claimants jump to litigation. In turn, compensation turns as much on litigation pressure as anything else. But with a workers' compensation scheme imposed through a trust, the story is different: Claimants must go to the trust first and thus cannot use pressure from their lawsuits to drive a settlement.[221] Instead, the trust draws on medical expertise to propose a compensation amount, while ultimately preserving Seventh Amendment rights if settlement negotiations break down.[222] The result is fewer litigation costs, more expertise in decision-making, and more consistency across victims.[223]

So, by coordinating creditor collection in bankruptcy and by subjecting tort claimants to a workers' compensation scheme, designer bankruptcy (either Manville or Two-Step) has much to offer. Further, by maintaining the productive assets of the business outside of bankruptcy, the Two-Step promises AssetCo a smoother set of business operations and saves bankruptcy costs, all of which accrues to the benefit of the tort victims in the form of more value to be distributed to them.

4. The Role of Bankruptcy.—As with asset partitions, much of the value of regulatory partitioning in bankruptcy has little to do with bankruptcy law or bankruptcy problems. Yet here too bankruptcy law acts as a convenient tool for achieving those partitions. And it may be the only such tool.

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218. 11 U.S.C. §§ 326–328.

219. 11 U.S.C. § 363.

220. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 523, 526–28 (2009).

221. *See also* McGovern, *supra* note 14, at 175 (noting original trust plans allowed trials "once certain negotiation and alternative dispute resolution procedures had been exhausted" but that subsequent "trust distribution plans . . . retain[] the right to a jury trial but made it sufficiently unattractive that claimants did not use it").

222. McGovern describes the process claimants must participate in with the trust before having access to courts. The process is run by claim-processing professionals that require "a claim form" with "medical . . . history." *Id.* at 167. Some plans may require specific medical evidence, such as "chest x-rays . . . pathology . . . and a physical exam" to recover, all of which must be assessed by the trust before a claimant can hale a tortfeasor into court. *Id.* at 172, 175.

223. *See* Kennedy, *supra* note 55, at 209 & n.61 (collecting sources that weigh costs and benefits of such compensation schemes, including lowering litigation costs).

The one area in which these regulatory partitions invoke a traditional bankruptcy tool to solve a traditional bankruptcy problem is creditor collection. At its heart, bankruptcy is debt-collection law and aims to prevent creditors from dismembering a business with going-concern value.[224] Bankruptcy does this by subjecting creditors to an automatic stay and forcing them into the bankruptcy court to orderly manage the process of distributing the debtor's value.

But the flipside—as seen in the Two-Step—is keeping the business operations themselves outside of bankruptcy to avoid bankruptcy's regulatory regime for debtors. This avoidance is decidedly not about using bankruptcy law and thus bankruptcy law plays no role in this regulatory partitioning effort.

Finally, consider the workers' compensation scheme imposed in a Manville trust. Such a scheme has nothing to do with traditional bankruptcy law or solving traditional bankruptcy problems. Indeed, the idea of such schemes originates in workplace accidents that can be more efficiently addressed with a regime of workers' compensation than one-off tort litigation.[225] None of that has to do with solvency challenges, reorganizing businesses, liquidity crunches, or any other traditional bankruptcy concern. Indeed, such regimes can be (and usually are) imposed by a separate statute that has no connection to insolvency law whatsoever.[226]

But here, as with asset partitioning, bankruptcy has convenient tools for achieving the benefits of such a compensation scheme. In particular, the flexibility granted to plans of reorganization and the ability to channel claimants into the trust make possible this *ex post* creation of a workers' compensation scheme.

And imposing such a scheme is impossible for a mass-tort defendant outside of bankruptcy. A mass-tort defendant could develop a compensation scheme and make offers to plaintiffs (or would-be plaintiffs). But nothing would force the plaintiffs into that scheme or require negotiation.[227] And plaintiffs would then have every reason to sue to better their bargaining position. That, in turn, could also rob future claimants of their compensation.

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224. JACKSON, *supra* note 34, at 10–11.

225. *See* NAGAREDA, *supra* note 33, at 66–67 (discussing workers' compensation schemes in the torts context).

226. *See, e.g.*, Richard A. Epstein, *The Historical Origins and Economic Structure of Workers' Compensation Law*, 16 GA. L. REV. 775, 776 (1982) (detailing the development of workers' compensation law as a replacement for one-off tort litigation).

227. *See* Samuel Issacharoff & D. Theodore Rave, *The BP Oil Spill Settlement and the Paradox of Public Litigation*, 74 LA. L. REV. 397, 398–403 (2014) (arguing that claimants in BP's voluntary settlement program received lower compensation than those in the class action because the settlements could not guarantee global peace).

So too efforts to impose a workers' compensation scheme in aggregate litigation have proven messy. Class actions over mass torts are all but dead in the wake of *Amchem Products, Inc. v. Windsor*[228] and *Ortiz v. Fibreboard Corp.*[229] And even when available, mass-tort class actions permit opt-outs.[230] Likewise, multidistrict litigation has struggled to develop compensation schemes that are attractive enough to obtain voluntary use by a supermajority of claimants.[231] And neither multidistrict litigation nor class actions offer protection for future claimants.[232]

Thus, bankruptcy offers much by way of regulatory partitioning, though not always through traditional roles of bankruptcy law. To be sure, bankruptcy is designed for coordinating creditor collection, one key regulatory partition. But it has no role in the out-of-bankruptcy reorganization sought in the Texas Two-Step. Nor does it have a traditional role in workers' compensation, but its toolbox happens to be well-suited for creating a workers' compensation scheme.

5. Pitfalls of Bankruptcy's Regulatory Partition.—The benefits of coordinating creditor collection and imposing a workers' compensation scheme come with little or no downside. But there is some risk created by the Texas Two-Step in keeping assets outside of bankruptcy. After all, bankruptcy's regulatory burdens on debtors exist for a reason: to protect creditors. Thus, a Manville bankruptcy avoids these pitfalls (though it forgoes the benefits as well), and the Two-Step embraces these benefits but with the risk of shortchanging claimants.

As canvassed above, in a Texas Two-Step, there is a risk that AssetCo will undertake risky projects, issue dividends to shareholders, or otherwise underfund tort victims' recoveries.[233] The bankruptcy court will have no jurisdiction over AssetCo and will thus be ill-positioned to prevent such maneuvers. Likewise, tort victims will not own stock (directly or through a trust) in AssetCo and thus are at the mercy of AssetCo shareholders. And the management of LiabilityCo will both lack information on AssetCo and will

228. 521 U.S. 591 (1997).

229. 527 U.S. 815 (1999); *see* Douglas G. Smith, *Resolution of Mass Tort Claims in the Bankruptcy System*, 41 U.C. DAVIS L. REV. 1613, 1615, 1631 (2008) ("The Supreme Court has cast significant doubt on the use of class action procedures in the context of mass tort claims . . . ."); D. Theodore Rave, *Closure Provisions in MDL Settlements*, 85 FORDHAM L. REV. 2175, 2178 n.11 (2017) (collecting sources on Supreme Court disfavoring class actions).

230. FED. R. CIV. P. 23(c)(2)(B)(v).

231. Rave, *supra* note 229, at 2176–77.

232. *See* Natalie R. Earles, *The Great Escape: Exploring Chapter 11's Allure to Mass Tort Defendants*, 82 LA. L. REV. 519, 531–32 (2022) (noting that litigation trusts will often run dry before future claimants can access them); Sergio Campos & Samir D. Parikh, *Due Process Alignment in Mass Restructurings*, 91 FORDHAM L. REV. 325, 328 (2022) (explaining bankruptcy's advantages over multidistrict litigation and class actions).

233. *See supra* section I(D)(3).

be installed by AssetCo for the purpose of letting AssetCo run its business unimpeded.

C. *Governance*

Most of the pitfalls of regulatory partitions are ultimately challenges of governance, that is, "rules that provide for the powers and duties of the managers and the rights of the beneficial owners."[234] To borrow from the governance terminology of corporate law, the challenges in designer bankruptcy center on care and loyalty.[235]

1. Care.—Start with care. In any legal entity, the aim is to have management with the prudence, expertise, and information to maximize the value of the entity. Thus, "the duty of care requires that fiduciaries inform themselves of material information before making a business decision and act prudently in carrying out their duties."[236] In designer bankruptcy, that is relevant for both the tort creditors' entity (tort trust, LiabilityCo) and the business entity going forward (SuccessorCorp, AssetCo).

Manville. The Manville Model does handle issues of care well for both legal entities.

For the tort trust, the Manville Model anticipates hiring experts in finance (to ensure funding lasts and avoid underfunding), medicine (to better understand tort causation/harm), and administration (to develop and implement the compensation scheme).[237] So the tort trust has all the information it needs to set up a compensation scheme and pay victims based

234. Sitkoff, *supra* note 36, at 428.

235. One complicated governance issue arises around governments with claims in bankruptcy. Mass torts often result in duplicate claims—the victim's and state's—so states are commonly in bankruptcy courts now too. *See* Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 EMORY BANKR. DEVS. J. 509, 511–12 (2021) ("[T]he bankruptcy system can be a force multiplier for government policymaking."). That can mean that there is a conflict between the government and the tort victims, both as to the mechanisms of compensation and the operation of the business. For considerations on handling the increasing role of governments in bankruptcy, see William Organek, Mass Tort Bankruptcy Goes Public 35–41 (Feb. 22, 2023) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4284113 [https://perma.cc/K2KL-P8JK]).

236. United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1049–50 (Del. 2021) (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)); *see also* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963) (stating directors must use the "amount of care which ordinarily careful and prudent men would use in similar circumstances"); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (stating directors may be liable if they do not ensure proper information and reporting systems to enable them to make prudent, informed decisions); Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369 (Del. 2006) (approving *Caremark* standard for board liability based on a lack of oversight).

237. *See generally* McGovern, *supra* note 14 (discussing the organization of trust distribution plans).

on their injuries. And the court will select, or allow tort claimants to select, prudent trustees.[238]

So too is the tort trust well-positioned to obtain information to oversee SuccessorCorp and protect tort claimants from any SuccessorCorp maneuvers that would harm them. It is, at a minimum, a shareholder[239] and likely the controlling shareholder.[240] The bankruptcy itself also generates significant information through schedules, disclosure statements, and the like.[241] That gives the trust access to information about SuccessorCorp[242] and some ability to chart the business's course to benefit tort claimants.

As for SuccessorCorp, old management stay in place, as is standard for a Chapter 11 bankruptcy.[243] So the people who understand the business best remain in charge and can prudently operate the business.

Texas Two-Step. The Two-Step handles care duties well on the AssetCo front, where it mirrors a Manville SuccessorCorp. But it is less effective for LiabilityCo.

For AssetCo, old management stay in place. So those with knowledge of the business continue operating it, just as in Manville. That is the right result from the care perspective.

But when it comes to care and LiabilityCo, things are different. LiabilityCo has no shares in AssetCo and thus no right to access information.[244] Likewise, no covenants in the funding agreement permit LiabilityCo to monitor AssetCo[245] or demand the information. So too AssetCo never files for bankruptcy and thus need not provide information to the bankruptcy court—schedules, disclosure statements, and the like. All of this hobbles LiabilityCo's ability to obtain key information and to oversee AssetCo. In turn, that restricts LiabilityCo's ability to head off machinations by AssetCo that would shortchange tort victims.

238. McGovern, *supra* note 14, at 169.

239. 11 U.S.C. § 524(g).

240. *In re* Johns-Manville Corp., 68 B.R. 618, 621 (Bankr. S.D.N.Y. 1986).

241. *See* FED. R. BANKR. P. 1007(b)(1) (schedules); 11 U.S.C. § 1125(b) (disclosure statement).

242. *See* George S. Geis, *Information Litigation in Corporate Law*, 71 ALA. L. REV. 407, 429 (2019) ("[C]orporate law has historically upheld inspection demands in three key situations: communicating with other shareholders, investigating corporate mismanagement, and valuing shares.").

243. *See* 11 U.S.C. § 1107 (describing rights, powers, and duties of debtor-in-possession).

244. *See supra* subpart I(D).

245. Covenants are a traditional way for financial creditors of corporations to protect themselves from opportunistic behavior and the classic principal–agent problem. Elisabeth de Fontenay, *The Use of Debt in Corporate Finance*, *in* CORPORATE LAW AND ECONOMICS 179, 191–92 (Adam B. Badawi ed., 2023); *see also* Robert M. Lloyd, *Financial Covenants in Commercial Loan Documentation: Uses and Limitations*, 58 TENN. L. REV. 335, 340–43 (1991) (describing typical financial covenants). The problem for tort claimants is that they do not, by definition, contract for covenants regarding their injuries and thus have none of these usual protections. *See supra* notes 154–55 and accompanying text.

Turning to the victims themselves, LiabilityCo, in its bankruptcy, need not establish a trust in its plan of reorganization.[246] And its plan, as a result, might not draw on the expertise in finance, medicine, and administration that proves valuable to tort claimants.

2. Loyalty.—In addition to information, management of the tort creditors' entity (trust or LiabilityCo) also need to have the right loyalties—"undivided and unselfish loyalty to the corporation"—to protect the tort victims.[247] Here again, the Manville Model proves better than the Texas Two-Step.

Manville. In a Manville trust, the trustees' duty of loyalty runs to the tort victims (the beneficiaries), and so the trustees will not act to benefit shareholders or creditors of the SuccessorCorp.[248] Better yet, trustees owe a duty of impartiality to the beneficiaries of the trust.[249] That means they will not favor present claimants over future ones or vice versa. So the duty of loyalty runs, as it should, to the tort victims.

As for the SuccessorCorp, its duties run to shareholders. Those shareholders, though, include the trust itself—as required by § 524(g).[250] Indeed, the trust may be the dominant shareholder in SuccessorCorp, as it was in Manville, where it owned 80% of the stock in the reorganized business.[251] So the loyalty of SuccessorCorp's management poses little risk of shortchanging tort victims. And even in a Manville Model case, where the trust does not control SuccessorCorp,[252] the information available and duty of loyalty ensure that the trustee will oversee and, if needed, sue SuccessorCorp over fraudulent transfers, debt/equity problems, or other maneuvers that would leave tort victims worse off.

Texas Two-Step. But for the Texas Two-Step, matters are different. That is true both for loyalty in LiabilityCo and loyalty in AssetCo.

246. Nothing in the Bankruptcy Code requires LiabilityCo to set up a trust.

247. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)); *see also* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.").

248. *See* Kane v. Johns-Manville Corp., 843 F.2d 636, 640 (2d Cir. 1988) (describing the trust as "a mechanism designed to satisfy the claims of all asbestos health victims, both present and future").

249. Sitkoff, *supra* note 38, at 650–52.

250. 11 U.S.C. § 524(g)(2)(B)(i)(III).

251. *In re* Johns-Manville Corp., 68 B.R. 618, 621 (Bankr. S.D.N.Y. 1986).

252. It is possible that Johnson & Johnson resorted to the Two-Step because it did not want to give tort victims stock in the business under § 524(g). By creating a LiabilityCo, then, Johnson & Johnson would have that entity's plan be subject to a § 524(g) bankruptcy—resulting in tort victims receiving stock, as required, but stock in an entity whose assets consist primarily of a funding agreement and which cannot control the operations of Johnson & Johnson's business.

In LiabilityCo, management come from LegacyCo itself and are likely on AssetCo's payroll. For example, in Johnson & Johnson's two-step, management of LTL (LiabilityCo) are seconded from a Johnson & Johnson parent corporation.[253] While they may pass the tests for conflicts of interest formally, they are likely installed because they will do what AssetCo wishes under the guise of loyalty to LiabilityCo.[254]

And it is notoriously difficult to challenge management in a bankruptcy on fiduciary duty grounds.[255] So tort victims, even with the most expert and informed management, are likely to be shortchanged by their own LiabilityCo because management will not challenge maneuvers by AssetCo that deprive the funding agreement of its assets.

As for AssetCo, it has no duty of loyalty to tort victims whatsoever. Formally, AssetCo is (at least it claims) a solvent company with a duty to its shareholders. Beyond that, it does not owe the tort victims anything—the divisional merger allocates tort liability to LiabilityCo and so tort victims are not even creditors of AssetCo. At most, AssetCo *may* consider its obligations to LiabilityCo, which in turn pays the tort victims, if AssetCo slips into insolvency (and admits it).[256] And even that seems unlikely, given the whole conceit of the Texas Two-Step.

It is this aspect that defenders of the Texas Two-Step most overlook. Foremost among the defenders, Anthony Casey and Joshua Macey have correctly pointed to the value that a Texas Two-Step can add and how that value can be directed to tort victims.[257] They likewise recognize the information problems raised by a Texas Two-Step, in particular how the business will have key information for valuation and may be able to divert value from tort victims.[258] But their proposal does little to get key information into the hands of tort victims, nor much to account for the control that the Texas Two-Step gives to management who are not beholden to tort victims.[259] By failing to ensure management who are loyal to tort victims, rather than shareholders, the Casey and Macey vision of the Texas Two-Step does not eliminate the ability of shareholders to use the Two-Step to appropriate the added value for themselves.

253. *In re* LTL Mgmt., LLC, 637 B.R. 396, 404 (Bankr. D.N.J. 2022), *rev'd*, 64 F.4th 84 (3d Cir. 2023).

254. *See* Ellias et al., *supra* note 159, at 1086–89 (explaining the rise of bankruptcy directors and how they might be biased in favor of the debtor).

255. *See* Pottow, *supra* note 158, at 219–23 (detailing numerous immunities enjoyed by trustees and the confused legal standards that come with suing a trustee).

256. *See generally supra* note 156 (collecting cases on fiduciary duties around insolvency).

257. Casey & Macey, *supra* note 217, at 977.

258. *Id.* at 1014–15.

259. *See id.* at 1017 (arguing that current disclosure regime in bankruptcy is adequate), 1019–20 (resisting proposals to oust old management or give tort creditors board control).

D. The Solvency Toggle

The key issue for deciding how to handle mass torts in bankruptcy is solvency.[260] A solvent mass-tort defendant does not need bankruptcy relief, but bankruptcy is a convenient mechanism for providing the relief it does need. Conversely, an insolvent mass-tort defendant (and its tort victims) does need to avail itself of the benefits of bankruptcy law, and these benefits differ depending on whether the defendant's underlying business has going-concern value.

1. Solvent Mass-Tort Defendants.—A mass-tort defendant that can pay its debts as they come due (cash-flow solvent) and has more assets than liabilities (balance-sheet solvent) suffers from no traditional bankruptcy problems—there is no run on assets because creditors are all paid in full as their debts (tort, contract, or otherwise) come due.[261] But designer bankruptcy can help such a defendant achieve the asset partitioning and regulatory partitioning that benefit defendant and creditors alike.[262]

On asset partitioning, a solvent mass-tort defendant benefits from defining a pool of assets for tort victims and another pool of assets for other creditors.[263] That partitioning eases the monitoring tasks of those creditors. And it avoids the debt overhang of tort liability.

So too the solvent mass-tort defendant (and tort creditors) benefit from the in-bankruptcy regulatory partitions that coordinate creditor collection in bankruptcy and allow a workers' compensation scheme to be imposed. That scheme increases the efficiency and fairness of compensation, delivering more compensation to victims in a more equitable, speedy fashion.

And, if the business operations can stay outside the bankruptcy partition, the benefits of designer bankruptcy (for defendant and tort victims alike) can be achieved without attendant costs. That will hold so long as the

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260. Others who have written on mass-tort bankruptcy have noted this issue (and its complexity) but typically confined their solutions to the scenario of an *insolvent* defendant where mass torts account for the overwhelming amount of the debt. *E.g.*, Smith, *supra* note 90, at 376, 419; Roe, *supra* note 90, at 874–75.

261. Though bankruptcy can play a role here in curing a debt overhang, which is one traditional role of bankruptcy law. Kenneth Ayotte & David A. Skeel Jr., *Bankruptcy Law as a Liquidity Provider*, 80 U. CHI. L. REV. 1557, 1572–73 (2013). And a number of famous mass-tort debtors are or claim to be in this position—solvent but needing to address a lot of tort debt. *See In re* LTL Mgmt., LLC, 637 B.R. 396, 404, 418 (Bankr. D.N.J. 2022), *rev'd*, 64 F.4th 84 (3d Cir. 2023) (noting solvency of Johnson & Johnson); Barliant et al., *supra* note 51, at 452 (noting Halliburton's solvency when it filed to use § 524(g) to manage asbestos liability).

262. *Cf.* Troy A. McKenzie, *Toward a Bankruptcy Model for Nonclass Aggregate Litigation*, 87 N.Y.U. L. REV. 960, 963–64 (2012) (arguing that bankruptcy's unique features offer benefits for aggregate litigation generally, not just in cases of insolvency).

263. *See supra* section II(A)(3).

defendant pays tort victims as their debts become due, either via jury verdict or settlement.

Thus, for a solvent mass-tort defendant, designer bankruptcy should do as follows. First, it should conduct *ex post* asset partitioning by creating a Tort Entity and a Business Entity. The Business Entity should contain operational assets, non-tort debt, and an obligation to pay the tort victims in full as obligations come due or to prepay the Tort Entity the full value of the claims. The Tort Entity should contain all tort debt and the right to payment from the Business Entity. The Tort Entity should also be entitled to any information it would receive if the Business Entity were in bankruptcy to ensure that the Business Entity does not undertake maneuvers that would push it into insolvency and deprive the Tort Entity of the assets to pay current or future victims. The Tort Entity should also be subject to bankruptcy's creditor-collection regime (critically, the stay for tort claimants and a channeling injunction), and it should use the bankruptcy to impose a workers' compensation scheme for tort victims.

On the ground, then, the tort victim will take her claim to the Tort Entity and reach a compensation amount, then be paid that compensation by the Tort Entity, which will draw on either the Business Entity's obligation or a prepayment by the Business Entity. And the Business Entity will continue normal operations subject only to oversight by the Tort Entity.

The bankruptcy endgame is for the Business Entity to pay every last victim or prepay the full value of the claims in cash. Then, the Business Entity can emerge from bankruptcy oversight by the Tort Entity and the Tort Entity no longer needs to be within bankruptcy to invoke that bankruptcy oversight.

2. Liquidations.—For an insolvent mass-tort defendant, there may be no going concern value. For example, if the tort liability incurred by running a mine exceeds the value produced by the mine, that mining business should be shut down and sold for parts.[264]

In such a scenario, the whole business should be in bankruptcy. So there is no need for an asset partition in the form of a Business Entity. Likewise, because the business is not persisting, there is no need for a bankruptcy partition—the whole business should be in bankruptcy court because there will be no Business Entity to operate outside of bankruptcy.

But there are benefits to having the in-bankruptcy partitions.[265] Creditor coordination still benefits from bankruptcy's coordination mechanisms. And

264. Vincent S.J. Buccola & Joshua C. Macey, *Claim Durability and Bankruptcy's Tort Problem*, 38 YALE J. REG. 766, 805 (2021).

265. *See supra* section II(B)(3).

a compensation scheme imposed through a Tort Entity will still be best for the tort creditors.

Thus, for an insolvent mass-tort defendant with no going-concern value, designer bankruptcy should do as follows. To begin, the entire business should file for bankruptcy. All creditors are then brought into that bankruptcy and subjected to its mechanisms of creditor coordination. In the bankruptcy, the court should impose a compensation scheme for tort claimants by creating a Tort Entity that will survive liquidation of the business. The business should then be sold through an ordinary liquidation, with proceeds distributed according to Bankruptcy Code priorities, resulting in the business's dissolution. At that point, the bankruptcy can end. All that will remain of the bankruptcy is the Tort Entity, which will exist to distribute compensation to victims according to the compensation scheme imposed in the bankruptcy.

3. Reorganizations.—The most complicated case is that of an insolvent mass-tort defendant with going-concern value. Essentially, though, this scenario mirrors the case of a solvent mass-tort defendant.

As with a solvent mass-tort defendant, there is value here in asset partitioning by creating a Business Entity and a Tort Entity. So too there is value in the in-bankruptcy partitions of coordinating creditor collection and imposing a workers' compensation scheme. And there is value in allowing the Business Entity to stay beyond the bankruptcy partition to better operate the business. Finally, as with a solvent mass-tort defendant, there is a need for the Tort Entity to oversee the Business Entity to ensure that it does not undertake maneuvers that shortchange the tort victims.

But, unlike the case of a solvent mass-tort defendant, the tort victims here are not entitled to full repayment. They are entitled to a pro rata recovery along with all other unsecured creditors.[266] Thus, the bankruptcy must determine that entitlement and must confirm a plan based on the baseline entitlements of all prebankruptcy creditors.

So the endgame scenario here calls for mirroring a Chapter 11 plan that includes two entities.[267] That will result in the Tort Entity's management acting as something like a tort-claimant committee,[268] negotiating a plan

266. Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 861–62, 861 n.16 (1996).

267. *See* 11 U.S.C. § 1123(a)(5)(C) (indicating that a merger or consolidation of the debtor with at least one more entity is an adequate means of implementing a Chapter 11 plan).

268. This trust structure also avoids some of the conflicts of interest of unsecured creditor committees, which represent a class of creditors and can press for their interest at the expense of the whole. *See* Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 473–75 (2011) (describing the vulnerabilities inherent to the unsecured credit committee structure). By having one entity (the trust) responsible for all tort creditors in the bankruptcy, and with a duty of impartiality among them, the institutional structure of the bankruptcy should not lend itself to favoring a class of tort claimants over others.

alongside the other creditors. That negotiation, in turn, will require a valuation of the business and an estimation of the tort claims to determine the pro rata share they would be entitled to, which serves as the baseline for negotiations.[269]

The bankruptcy will then end when the court confirms a negotiated plan. That plan will require funding the Tort Entity and a workers' compensation scheme that tort claimants are channeled into. It will also grant the Business Entity a discharge and vest assets so that the Business Entity operates, going forward, free of any further bankruptcy obligations.

III. Designing Mass Tort Bankruptcy

All the benefits and downsides catalogued in Part I fit into the theoretical framework described above. This Part explains conceptually how they fit together and how, in turn, to think about ways of achieving the benefits while mitigating the downsides. The first subpart does the conceptual work. Then the next two offer suggestions for Congress to design a mass-tort bankruptcy scheme and, absent that, considerations for judges faced with mass-tort bankruptcies.

A. From Theoretical Framework to Design

The analysis above lends itself to a design that harnesses the benefits of organizational law while minimizing the pitfalls. And it lends itself to a design that has the flexibility to manage a bankruptcy in any of the solvency scenarios. For a mass-tort defendant, that design is as follows.

Filing. At filing, the mass-tort defendant files as one entity. Upon filing, it splits immediately into two entities, Business Entity and Tort Entity.

The aim of splitting the entities is to gain the benefits of asset partitioning and regulatory partitioning for operating a business out of bankruptcy. The role of having the entire mass-tort defendant file, rather than split first, is to ensure that the whole enterprise falls within the jurisdiction of the bankruptcy court.[270] That makes a discharge uncomplicated (there are no third-party releases), and it ensures that the bankruptcy court can issue orders to any part of the enterprise (which is key for governance).

The Business Entity. The Business Entity, in the split, will be allocated all operational assets of the business and all non-tort debt. It will also be obligated to pay the Tort Entity amounts required by the bankruptcy court. Old management will continue in place, operating the business without being subject to bankruptcy law absent an order by the bankruptcy court.

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269. *See supra* section II(D)(2).

270. *Cf. In re* LTL Mgmt., LLC, 58 F.4th 738, 758–59 (3d Cir. 2023) (explaining that only a debtor's financial condition is considered, rather than financial condition of other entities not before the court).

The aim here is to capitalize on the benefits enabled by the split: allowing a business to operate more smoothly outside of bankruptcy. At the same time, maintaining an obligation to pay tort creditors ensures that tort creditors receive what bankruptcy entitles them to, and that they benefit from the value added by keeping the business beyond bankruptcy's regulations. Because the Business Entity is still subject to the jurisdiction of the bankruptcy court, the court can issue orders that prevent maneuvers that would shortchange tort victims.[271]

The Tort Entity. The Tort Entity will have the right to payment from the Business Entity and any nonoperational assets the Business Entity contributes in the initial split.[272] It will also contain all of the tort liability, with the bankruptcy court issuing a channeling injunction that requires tort claimants to seek redress from the Tort Entity alone.[273] The Tort Entity should take the form of a trust, with an obligation to all tort victims and thus a duty of impartiality among them.[274] And that trust should be required to develop an administrative process for claims, mirroring that of asbestos trusts—default compensation grounded in medical expertise and a focus on settlement that preserves the jury right, but only after the negotiation and settlement option has failed. Finally, the trust should be entitled to any information about the Business Entity that it could receive in bankruptcy and should be empowered to litigate to prevent maneuvers that put tort-victim recovery at risk.

The aims here are manifold. For starters, by creating a trust, the Tort Entity ensures a pool of assets for tort victims. The channeling injunction and administrative scheme allow for the regulatory partition benefits—they prevent tort creditors from dismembering a viable business and ensure that compensation tracks medical reality rather than litigation pressure. That also saves significant litigation costs, leaving more money for victims instead of lawyers. Finally, the information allows the trust to conduct oversight and solves the governance problem that is normally created by a Texas Two-Step. There, the out-of-bankruptcy AssetCo has free rein, and neither the bankruptcy court nor management of the in-bankruptcy LiabilityCo have the means to prevent the shortchanging of tort victims; here, the information, loyalty to victims, and standing to sue ensure that the trust has all that it needs

271. *See* 11 U.S.C. § 105 (outlining the power of the court to issue "any order, process, or judgment that is necessary or appropriate" to carry out the aims of bankruptcy).

272. *See, e.g.*, *In re* LTL Mgmt., LLC, 637 B.R. 396, 402 (Bankr. D.N.J. 2022), *rev'd*, 64 F.4th 84 (3d Cir. 2023) (describing $367.1 million in revenue streams allocated to Johnson & Johnson's LiabilityCo).

273. *See In re* Joint E. & S. Dist. Asbestos Litig., 982 F.2d 721, 726 (2d Cir. 1992) (noting that such a settlement process can be imposed through the trust).

274. Sitkoff, *supra* note 38, at 650–52.

to ensure that the benefits of keeping the business out of bankruptcy accrue to the tort victims and not just the business's shareholders.

Solvency Determination. This initial structure at filing works when there is a business worth keeping alive. And the structure is easy to convert into a liquidation. The main question, and the next key juncture in the bankruptcy, is determining which of the solvency scenarios holds. That, in turn, allows the court to direct the rest of the course of the bankruptcy.

To determine the solvency scenario, the court must do three things. First, it must conduct a valuation of the business.[275] Second, it must estimate the tort claims.[276] Third, it must determine if the business has going-concern value.[277] Together, these considerations will tell the court if the mass-tort defendant is solvent, insolvent but a candidate for reorganization, or insolvent and in need of liquidation. The determination of solvency, in turn, lets the court chart the course of the bankruptcy.

The Solvency Endgame. Start with solvency. If the mass-tort defendant is solvent, nothing needs to change. Tort victims who have received jury verdicts prebankruptcy will be paid without delay. And tort victims who settle with the trust (or later obtain jury verdicts) will be paid as they settle. Once the last victim is paid or the trust is fully funded with cash to satisfy the estimation, the Business Entity can emerge from bankruptcy.

In the interim, the Business Entity will continue operating normally. And the trust will oversee the Business Entity to ensure that it takes no maneuvers that render it insolvent and thus deprive tort victims of a full recovery.

The Reorganization Endgame. The reorganization scenario largely mirrors the solvency one. The Business Entity will continue operating without bankruptcy restrictions but subject to Tort Entity oversight. And tort claimants will bring their claims to the trust for settlement.

The difference is that here tort claimants are not entitled to full recovery, but a pro rata share of what unsecured claimants would recover in a bankruptcy of the whole enterprise.[278] That means, in parallel to the trust settling with tort claimants, there must be a Chapter 11 negotiation among all prebankruptcy creditors. In that negotiation, the trust should represent all tort

275. *See generally* Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061 (1985) (describing methods of valuation for assets).

276. 11 U.S.C. § 502(c). In doing so, the court should come up with a dollar value that in fact reflects the tort liability rather than follow a practice that has developed among judges of "estimating" each claim at $1. GIBSON, *supra* note 142, at 132. That practice eases the process of voting on a plan but does nothing for the solvency determination that is critical here.

277. *See* Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small-Business Bankruptcies*, 50 J.L. & ECON. 381, 382 (2007) (concluding that the bankruptcy process sorts effectively between businesses that should continue and those that should shut down).

278. Bebchuk & Fried, *supra* note 266, at 861–62, 861 n.16.

claimants and will have negotiating power in line with the total estimated tort liability. The negotiations, in turn, will result in a plan for both the Business Entity and the Tort Entity,[279] funding the trust based on its bankruptcy-law entitlements and ultimately granting the Business Entity a discharge, after which it can emerge from bankruptcy.

The Liquidation Endgame. If liquidation proves to be the right course, then the whole mass-tort defendant should be sold off in one bankruptcy case. Here, converting from the initial structure will be easy. Because the Business Entity is subject to bankruptcy court jurisdiction, a substantive consolidation with the Tort Entity (yielding one bankruptcy case to sell off assets) faces no doctrinal challenges.[280] That consolidation also leaves the bankruptcy court with a normal liquidation—the entire business's assets are sold and distributed based on Bankruptcy Code priorities.[281] The one difference is that now a trust exists with a workers' compensation scheme, ensuring that tort victims are repaid more efficiently, fairly (including future victims being accounted for), and with fewer litigation costs than they would incur outside of bankruptcy.[282]

As a final point, this design has the additional benefit of making it easy to switch among scenarios, something that tracks the reality of bankruptcy. This design accounts for that: the difference between the solvency and reorganization scenarios is just whether a plan needs to be negotiated and confirmed. Moving from solvency or reorganization to liquidation just requires a substantive consolidation. So a bankruptcy court is well-positioned not only at the outset of the case, but later on too if the developments require a change in course.[283]

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279. 11 U.S.C. § 1129.

280. *See* Mary Elisabeth Kors, *Altered Egos: Deciphering Substantive Consolidation*, 59 U. PITT. L. REV. 381, 384–85 (1998) (outlining considerations courts use to substantively consolidate, including creditors dealing with the entity as an economic unit, entanglement of the entities' affairs, and weighing of benefits and harms). *See generally id.* (reviewing precedent).

281. Michelle J. White, *Bankruptcy Law*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 1013, 1019 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

282. Another bonus here is that the trust will likely be able to credit-bid the amount of the tort liability. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 647 (2012) (holding that secured creditors have a right to credit-bid). That will ensure a high price for the assets and a competitive auction. And if the trust wins the auction, it will have the resources to do something of value with the assets.

283. All this analysis raises the question of why we should not impose such a scheme outside of mass tort cases as well. And perhaps we should. But there are reasons to recognize mass tort as unique. To begin, a major benefit of mass-tort bankruptcy is the ability to impose an administrative compensation scheme, which means that the scheme described here contemplates an expansion of bankruptcy to debtors who face no financial challenges, which is categorically different from the contemporary rule in bankruptcy. *In re* LTL Mgmt., LLC, 64 F.4th 84, 101 (3d Cir. 2023). Also, the scheme above essentially shifts power from the bankruptcy court to a trustee who is loyal to all of the creditors and can oversee the Business Entity. That only works when creditors are similarly

B. Congress

Congress can enact the scheme above by statute. Doing so falls comfortably within its Bankruptcy Power and Commerce Power, and so long as the trust preserves the Seventh Amendment rights of tort claimants, there should be no constitutional concern.[284]

Enacting that statute would require a new mass-tort section or subchapter in the Bankruptcy Code, as the current provisions do not dovetail in ways that already allow judges to create this scheme.[285] For that new section, two additional issues should be considered beyond the design points above.

The first issue is eligibility. Congress will need to define "mass-tort bankruptcy" to allow access to those cases that are large enough to justify the costs of creating a trust and are also good candidates for using bankruptcy as a means of aggregate litigation.

For case size, the definition should focus on assets for distribution to unsecured creditors. It matters little whether the tort liability is $1 billion or $100 billion; rather, the assets' value should be enough to justify the costs of a trust (and attendant professionals) to distribute those assets equitably. The precise number is impossible to determine, but Congress can begin with the costs of asbestos trusts and ultimately reach a sensible amount. Such a hard-and-fast rule will serve courts, defendants, and tort victims alike in clarifying when such mass-tort bankruptcies under the Bankruptcy Code will be required.

As for the aggregate litigation side, the mass-tort bankruptcy subchapter aims to replace multidistrict litigation and class actions on the theory that bankruptcy's tools—stay, injunctions, discharge—are a better means of managing and concluding such litigation. Given that, the test for the subchapter should mirror those means of aggregating litigation—essentially a case that would be eligible for multidistrict litigation or a class action should be eligible for such a mass-tort subchapter. Perhaps those standards should be expanded, but as a baseline, Congress should copy them.

The second issue is the inverse of eligibility—Congress should force all such bankruptcies to use the section. As noted above, there are risks to tort victims of a Texas Two-Step.[286] So it is better for Congress to channel such bankruptcies into the new mass-tort section, which appropriately protects the tort victims.

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situated, and thus, the oversight can be consolidated in a trustee who is loyal to all creditors. With diffuse creditors who have different interests, oversight of the Business Entity would devolve into chaos as each creditor faction tried to press management to favor them.

284. U.S. CONST. art. I, § 8, cl. 3–4; United States v. Lopez, 514 U.S. 549, 558–59 (1995).

285. *See infra* subpart III(C).

286. *See supra* subpart I(D).

One way to do so is to deny third-party releases outside of those authorized in the mass-tort section. Because the Two-Step relies on such a release for AssetCo, such a provision forces the Two-Stepper to use the new section.[287] Alternatively, the section could authorize a judge to convert a filing to one under the section. Conversion, however, is a vast expansion of involuntary bankruptcy (because it forces AssetCo into the LiabilityCo bankruptcy), one which judges hesitate to use.[288]

In sum, mass-tort cases will be eligible for the subchapter if the assets available to unsecured creditors exceed a set dollar value and if the litigation would otherwise be eligible for either a class action or multidistrict litigation. And such litigation will be channeled into the subchapter, where tort creditors are better protected.

C. Courts

Courts faced with a designer bankruptcy are in a trickier position than Congress, as many of the mechanisms for designing these designer bankruptcies are not available under current law. Thus, this subpart offers guidance to courts faced with a Texas Two-Step (the latest, and likeliest, designer bankruptcy) on how to maximize the benefits above and minimize the pitfalls above within the confines of current bankruptcy law.

To that end, this subpart angles at a solution that achieves the following: First, the benefit of keeping the operating business outside of the bankruptcy partition. Second, the benefits of keeping the creditor collection within the bankruptcy partition, and where possible, the benefit of imposing a workers' compensation scheme for that creditor collection. Third, the benefit of a true asset partition, whenever possible, between the operating business (AssetCo) and the Tort Entity (LiabilityCo). Fourth, a governance regime that ensures AssetCo does not shortchange LiabilityCo. And finally, an endgame for the bankruptcy that tracks the entitlements of the Bankruptcy Code.

To achieve those benefits and minimize those risks, the structure of the Texas Two-Step is a good start that requires a few tweaks. AssetCo is an operating business that benefits from staying outside of the bankruptcy partition. And LiabilityCo is a creditor collection entity inside of bankruptcy. To ensure a clean partition, a court should extend a third-party injunction, preventing tort creditors from suing AssetCo and thus channeling their claims to LiabilityCo.

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287. *See supra* subpart I(D). In theory, this could deter the use of bankruptcy altogether, though given the limitations of class actions and multidistrict litigation, it seems likely that mass-tort defendants would still prefer the mass-tort bankruptcy section (with protections for creditors) to the alternatives.

288. *See* Richard M. Hynes & Steven D. Walt, *Revitalizing Involuntary Bankruptcy*, 105 IOWA L. REV. 1127, 1128, 1135–36 (2020) (noting that involuntary bankruptcy is disfavored and seldom used).

That, however, leaves two problems. For starters, LiabilityCo is not, and need not, establish a workers' compensation scheme to better manage tort claims. Nothing in the Bankruptcy Code permits a court to impose such a scheme on its own, so the most the court can do is pressure the debtor.

The second problem is governance, which stems from the management of LiabilityCo lacking the information and motivation to protect tort victims. This problem, though, can be mitigated. The court can, and should, replace management of LiabilityCo with an appointed trustee.[289] That trustee will not be on the payroll of AssetCo and will be loyal solely to the tort victims.[290] And the trustee's broad investigative powers will allow it to conduct oversight of AssetCo to prevent it from shortchanging tort claimants.

That initial structure comes close to replicating the statutory scheme described above.[291] Once that structure (with a trustee) is in place, the court should determine the proper endgame for the bankruptcy.

As in the statutory scheme, the key issue for determining that endgame is solvency. Thus, the court must determine if the entire enterprise (AssetCo and LiabilityCo) is solvent, insolvent with going-concern value, or insolvent without going-concern value. To do that, the court will need to value the business, estimate the value of the tort claims, and use the typical information to determine going-concern value.[292]

The tools to do so are all available. A judge may estimate the value of tort claims in aggregate.[293] A judge may also conduct a valuation of the business.[294] And the trustee's investigation will provide information on

289. *See* 11 U.S.C. § 1104(a)(1)–(2) (requiring a trustee for cause, in cases "including fraud, dishonesty, incompetence, or gross mismanagement" and allowing appointment of a trustee if "in the interests of the creditors"). Courts have read the for-cause language to include cases of conflicts of interest like those present in the Texas Two-Step. *See* 7 COLLIER ON BANKRUPTCY § 1104.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2023) (including conflicts of interests among factors relevant to the existence of cause). And though courts often hesitate to appoint a trustee given the cost and the fact that current management have expertise in the business that a trustee may lack, here management's expertise in the AssetCo business helps them little with the tort claims (the bulk of LiabilityCo's day-to-day in bankruptcy) so there is less reason to defer to old management.

290. 7 COLLIER ON BANKRUPTCY § 1106.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2023). This includes a requirement of disinterestedness, which prevents the trustee from having any interest "materially adverse to the estate." 11 U.S.C. § 101(14).

291. The major differences are that AssetCo will be beyond the court's jurisdiction and that LiabilityCo is typically a limited liability company and need not be, or become, a trust for tort victims. *See supra* subpart III(B).

292. *See* Morrison, *supra* note 277, at 396–97 (describing characteristics of firms that ought to be shut down versus rehabilitated).

293. 11 U.S.C. § 502.

294. *See generally* Fortgang & Mayer, *supra* note 275, at 1061 (describing methods of valuation for assets).

whether AssetCo has going-concern value or ought to be liquidated.[295] Together, then, they can tell the court which endgame scenario is appropriate for the bankruptcy.

Solvency. Suppose AssetCo is solvent. In that scenario, there is no reason to delay paying the tort victims who have already won verdicts, so the judge should lift the stay and third-party injunction for any such victims. Then AssetCo, as bound by the funding agreement, will pay them the dollar amount of the jury verdict.

For those who have sued or brought claims to bankruptcy but have not won a jury verdict, the court should allow their claims to proceed (lifting the stay and third-party injunction) unless LiabilityCo creates (or becomes) a trust that exists to administer a compensation scheme. The reason for doing so is that bankruptcy can legitimately be used to take advantage of such an administrative scheme, and that scheme is preferable to litigation.[296] So if the debtor wishes to take advantage of that regulatory partition in bankruptcy, it should be encouraged to. But if a solvent debtor does not seek to take advantage of such a scheme, then the bankruptcy is merely a delay tactic—everyone is entitled to be paid in full and there is no need for bankruptcy to coordinate creditor collection for a limited pool.[297]

Liquidation. If valuation and claims estimation show AssetCo to be insolvent, and information from the trustee suggests that AssetCo lacks going-concern value, the court should liquidate the entire business. That can be achieved by substantively consolidating AssetCo and LiabilityCo.[298] The court can then convert the case to a Chapter 7 bankruptcy, liquidating in ordinary fashion and distributing proceeds based on Bankruptcy Code priorities. Here too the court should press for converting LiabilityCo into a trust that administers a compensation scheme and can represent all tort claimants through the liquidation. At a minimum, the court should appoint a

295. *See* 11 U.S.C. § 1106(a)(3) (granting the appointed trustee wide scope to investigate "any other matter relevant to the case or to the formulation of a plan"); FED. R. BANKR. P. 2004 (explaining the scope of examination).

296. *See supra* subpart III(A).

297. The tort victims of a solvent debtor are entitled to 100 cents on the dollar, as are all other creditors of a solvent debtor. So bankruptcy is not preventing creditors from eating into each other's recoveries in the case of a solvent debtor. It is just delaying the time frame for paying the victims. 11 U.S.C. § 507(a) (listing priorities).

298. Courts tend to disfavor consolidation of nondebtors, so depending on the circuit, this may be a tall order. As Kara Bruce notes, courts nominally apply the same test for substantive consolidation of nondebtors but, in practice, tend to require fraud or disregard of the corporate form before drawing a nondebtor into the bankruptcy. Kara Bruce, *Non-Debtor Substantive Consolidation—A Remedy Built on Rock or Sand?*, 37 BANKR. L. LETTER, Mar. 2017, at 1, 2; *see also* 2 COLLIER ON BANKRUPTCY § 105.09 (Richard Levin & Henry J. Sommer eds., 16th ed. 2023) (collecting cases across circuits and noting the parallel to the doctrine of alter ego liability).

future-claims representative to protect those victims who would otherwise be unprotected.[299]

Reorganization. If valuation, claims estimation, and the trustee together suggest that AssetCo has going-concern value, the court should shepherd the process through a typical Chapter 11 plan. Here too, it makes sense for the court to press LiabilityCo to become a trust that administers a compensation scheme[300] and, failing that, to appoint a future claims representative. In either scenario, the aim is to ensure that all tort creditors are represented in the plan negotiations.

In terms of the process, all prebankruptcy creditors must be included.[301] That means the plan itself will include the in-bankruptcy LiabilityCo and the out-of-bankruptcy AssetCo.[302] And it will yield payment to the tort creditors, along with a fund for future claimants, based on the recovery provided for in the plan.[303]

All told, then, courts superintending a Texas Two-Step bankruptcy have a fair number of tools to capture that designer bankruptcy's benefits while minimizing its pitfalls. And courts can cobble together those tools to ensure the protection for tort victims that promises benefits for all—business and tort victim alike—even if Congress does not legislate the ideal, statutory scheme.

Conclusion

Bankruptcy today relies on careful design by businesses of which of their assets, liabilities, and legal entities enter bankruptcy. That design has the great promise of tailoring a bankruptcy regime to minimize the burdens of bankruptcy law for operating businesses. At the same time, those designer bankruptcies create risks for creditors, most notably the tort victims who find themselves the target of many of today's designer bankruptcies.

But such dangers can be curtailed. With a careful understanding of bankruptcy's role, and organizational law's role, these mass-tort

299. *See, e.g.*, *In re* Johns-Manville Corp., 36 B.R. 727, 741 (Bankr. S.D.N.Y. 1984) (suggesting that the appointment of a future claims representative will ensure that "all interests will be more fully put forward and protected").

300. Because the debtor has the exclusive right to propose a plan for 120 days, 11 U.S.C. § 1121(b), an appointed trustee will likely move the bankruptcy along quickly and in the interest of the tort creditors. That obviates some of the delay concerns that arise when LiabilityCo's old management are beholden to AssetCo shareholders and may seek to use bankruptcy to delay paying tort victims, especially if AssetCo suffers no burdens of bankruptcy.

301. If a prebankruptcy creditor who is not a tort creditor receives 100 cents on the dollar (by avoiding the bankruptcy altogether) and tort creditors receive less (because the bankruptcy plan curtails their recovery), the plan should be held to "discriminate unfairly." *Id.* § 1129(b)(1).

302. *See id.* § 1123(a)(5)(C) (allowing merger or consolidation in a plan).

303. This kind of plan will only work if there is a third-party release, and thus only work in certain circuits. *See supra* note 165.

bankruptcies can be better designed to harness the benefits of such design and minimize the risks of such design. And doing so leaves more value on the table for businesses and tort victims alike. Hence, whether imposed by statute or judicial superintendence, an improved design holds promise for both a better bankruptcy system in general and a better bankruptcy system for managing mass torts that are, in today's world, in dire need of a well-designed bankruptcy system.