

SCARLET-LETTERED BANKRUPTCY: A PUBLIC BENEFIT PROPOSAL FOR MASS TORT VILLAINS

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ABSTRACT—Financially distressed companies often seek refuge in federal bankruptcy court to auction valuable assets and pay creditor claims. Mass tort defendants—including 3M, Johnson & Johnson, and Purdue Pharma—introduce new complexities to customary Chapter 11 dynamics. Many mass tort defendants engage in malfeasance that inflicts widespread harm. These debtors fuel public scorn and earn a scarlet letter that can destroy value for an otherwise profitable business. Scarlet-lettered companies could file for bankruptcy and quickly sell their assets to fund victims’ settlement trusts. This Article argues, however, that this traditional resolution option would eviscerate victim recoveries. Harsh public scrutiny has diminished the value of the resources necessary to satisfy claims, creating a discount that must be borne by victims.

My public benefit proposal charts a new course. Instead of accepting fire-sale prices and an underfunded settlement trust, the scarlet-lettered company emerges from bankruptcy as a corporation for the public benefit. This modified reorganization offers victims the greatest recovery. The continued operation preserves value during a transition period, after which the going concern can be sold efficiently. Assets that have been tainted by tortious conduct are cleansed behind a philanthropy shield and then sold to capture the value rebound. The victims’ collective is the owner of the new company and can participate in a shareholder windfall if there is strong postbankruptcy performance.

At the forefront of a new trend in aggregate litigation, this Article proposes a public benefit alternative to traditional resolution mechanisms. This approach delivers utility that will support application in a variety of contexts, assuming certain governance safeguards are maintained. In our new age of greater personal and corporate accountability, more scarlet-lettered companies will emerge and ultimately land in bankruptcy. The need to address the disposition of tainted assets will be paramount in compensating mass tort victims trying to reassemble fractured pieces. This Article explains a new phenomenon and reconceptualizes resolution

dynamics in a way that will have policy implications that transcend aggregate litigation.

AUTHOR—Professor of Law, Lewis & Clark Law School. For helpful comments and conversations, I am grateful to Ken Ayotte, Ronit Berkovich, Christopher Bradley, Andrew Bradt, Vince Buccola, Sergio Campos, Zachary Clopton, Marshall Huebner, Lynn LoPucki, Robert Rasmussen, David Skeel, and Katherine Waldock. I thank my family for their unwavering support. I also want to thank the members of the *Northwestern University Law Review* for their helpful comments and corrections.

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INTRODUCTION

Dr. Robert Kaiko did not intend to cause a national health crisis. The doctor was Purdue Pharma’s vice president of clinical research in 1990.¹ The company’s patent on MS Contin had just expired,² and competition from generic manufacturers was going to decimate profits.³ The executive team had been given the daunting task of saving the company.

On July 16, 1990, Dr. Kaiko wrote a pedestrian memorandum that had a radical proposal: Purdue should formulate a new pain medication based on the opioid oxycodone.⁴ Oxycodone had a number of benefits, including the ability to facilitate stable pain management.⁵ Kaiko believed that no other pharmaceutical firm was developing pain medication incorporating the drug.⁶ Thus, a “controlled-release oxycodone [would be] less likely to initially have generic competition.”⁷ Purdue would enjoy a first-mover

¹ Harriet Ryan, Lisa Girion & Scott Glover, ‘*You Want a Description of Hell?*’ *OxyContin’s 12-Hour Problem*, L.A. TIMES (May 5, 2016), <https://www.latimes.com/projects/oxycontin-part1/> [<https://perma.cc/7LPD-T7W7>].

² Daniel J. Hemel & Lisa Larrimore Ouellette, *Innovation Institutions and the Opioid Crisis*, 7 J.L. BIOSCIENCES 1, 8 (2020).

³ See Christopher Glazek, *The Secretive Family Making Billions from the Opioid Crisis*, ESQUIRE (Oct. 16, 2017), <https://www.esquire.com/news-politics/a12775932/sackler-family-oxycontin/> [<https://perma.cc/C7ER-UVS6>].

⁴ See *Purdue’s Need for a New Painkiller*, L.A. TIMES: OXYCONTIN FILES (May 5, 2016), <https://documents.latimes.com/purdues-need-new-painkiller-1990/> [<https://perma.cc/5PAY-J9HT>].

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

premium. But there was one serious concern. Oxycodone can be up to twice as potent as morphine, and—even at that time—some states had identified the drug as one of the most abused narcotics in the country.⁸

Kaiko’s proposal presented significant ethical questions, but not to Richard Sackler. Sackler believed that oxycodone’s addiction gravity was an opportunity, not a moral quandary.⁹ Purdue executives knew that medical professionals misunderstood oxycodone because of a convenient malapropism.¹⁰ Many physicians confused the suffix “-codone” with “codeine,” a mild pain suppressant prevalent in various over-the-counter products.¹¹ Purdue could manufacture one of the most addictive drugs in medical history and rely on a creative marketing campaign to obscure this fact. Sackler believed that sales would be staggering if he could just get the product in patients’ hands.¹² He was right.

OxyContin prescriptions during the drug’s 1996 launch year exceeded 300,000.¹³ By 2001, prescriptions exceeded six million.¹⁴ Sales topped \$1 billion for that year alone.¹⁵ By 2004, OxyContin was the most prevalent prescription opioid abused in the United States.¹⁶ By the end of the 2000s, Americans—who represent less than 5% of the world’s population—were consuming more than 80% of the world’s opioids.¹⁷ Purdue is not solely responsible for the opioid crisis, but it developed the fountainhead drug and depraved distribution strategies that others in the industry would follow.¹⁸

Purdue’s day of reckoning did not come for many years. But in a previous generation, the company may not have answered for its depravity at all. The change can be attributed to a newfound sense of personal and corporate accountability.¹⁹ As I discuss in Section II.A, *infra*, online social

⁸ See *id.* (noting that “in the state of Connecticut and perhaps other states, the substance abuse officials consider oxycodone combinations among the most abused of Schedule II narcotic analgesic drugs”).

⁹ See Glazek, *supra* note 3.

¹⁰ See *id.*

¹¹ *Id.*

¹² *Id.*

¹³ See *id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ See Bethany McLean, “We Didn’t Cause the Crisis”: David Sackler Pleads His Case on the Opioid Epidemic, VANITY FAIR (June 19, 2019), <https://www.vanityfair.com/news/2019/06/david-sackler-pleads-his-case-on-the-opioid-epidemic> [<https://perma.cc/V59L-EBFR>].

¹⁷ *Id.*

¹⁸ See Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. (forthcoming 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3649611 [<https://perma.cc/F9GX-FWPT>]; *infra* notes 121–122 and accompanying text.

¹⁹ See *infra* note 109.

networks have enabled young people to mobilize and demand action in response to the perceived inability of traditional institutions to prevent criminal behavior. The result is increased scrutiny on a broad cross-section of individuals and corporate entities, from Bill Cosby to Johnson & Johnson. Evil is in the spotlight. And criminal prosecution is not enough. Victims need financial compensation, but the most daunting resolution obstacles exist in this sphere.²⁰

This Article offers a theoretical analysis of the resolution complexity facing a unique subset of mass tort defendants I refer to as “scarlet-lettered companies.” These companies have inflicted harm on a significant segment of the population. But it is the scale and depravity of their tortious conduct that creates deep-seated public scorn, earning each one a scarlet letter that can ultimately destroy an otherwise profitable business. Unfortunately, this punishment harms mass tort victims, whose recovery is invariably tied to the liquidation of tainted corporate assets.

Scarlet-lettered companies could file for bankruptcy and quickly sell their assets to fund a settlement trust to compensate victims. The strategy involves conducting an auction and using the proceeds—along with funds provided by affiliated corporate entities or applicable insurance policies—to establish a victims’ trust that would ultimately receive, analyze, and pay claims related to the debtor’s pre-petition tortious conduct.²¹ The literature on bankruptcy asset sales has touted the process’s ability to efficiently preserve value for creditors.²² But historical models fail to capture mass-restructuring dynamics.

²⁰ See *infra* notes 109–113 and accompanying text.

²¹ See Parikh, *supra* note 18, at 34–36.

²² See, e.g., THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 223 (1986) (describing the flexibility benefits of Chapter 7 bankruptcy); see also Michael C. Jensen, *Corporate Control and the Politics of Finance*, 4 J. APPLIED CORP. FIN. 13, 31–32 (1991) (“The auction process would thus have two major advantages over the current system. First, it would separate the task of assessing the firm’s value from that of dividing that value among creditors and equityholders, effectively assigning the first to capital markets and the second to the courts. Second, it would shelter the value of the firm’s operations from the destructive conflicts among creditors and equityholders over the division of firm value—conflicts that make the current formal bankruptcy process so inefficient.”); Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANKR. INST. L. REV. 69, 71–72 (2004) (describing how sales can protect smaller investors and maximize the price the assets fetch); Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 685–93 (2003) [hereinafter Baird & Rasmussen, *Chapter 11*] (asserting that “asset sales are a way to preserve what going-concern value may exist by putting the corporation’s assets into new hands”); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 777–88 (2002) [hereinafter Baird & Rasmussen, *Bankruptcy*] (describing the modern state of going-concern sales). *But see* Lynn LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 3–4 (2007) (challenging Baird and Rasmussen’s assertion in *The End of Bankruptcy* that markets are the most viable substitute for the reorganization process).

Scarlet-lettered companies face harsh public scrutiny, which creates a residual stain that diminishes the value of the very resources necessary to provide victims an equitable recovery. Rushed bankruptcy auctions can preserve value in many cases, allocating a speed premium to creditors. Scarlet-lettered auctions do not enjoy this premium. These auctions face a staggering speed discount because public scorn and the fear of social norms deter bidder entry and promote cautionary bidding. The consequences of a rushed, scarlet-lettered auction are severe.²³ An inefficient auction realizes diminished proceeds, increasing the risk of a prematurely insolvent victims' trust—the only source of recovery for mass tort victims. Bankruptcy's dirty little secret is that these trusts have no backstop upon failure.²⁴ The corporate tortfeasor is liquidated and no longer exists. Insurance companies, the parent entity, and affiliated entities all receive releases through the case. Professionals and other intermediaries who may have agreed to a poor settlement have immunity. If the debtor's assets were auctioned, the acquirer does not assume any pre-petition liability. Victims have ostensibly no recourse. I argue, however, that a doomed auction is not the only option.

My public benefit proposal charts a new course. Instead of accepting fire-sale prices and an underfunded settlement trust, the scarlet-lettered company would emerge from bankruptcy as a corporation for the public benefit, effectuating an equitable balance by deploying the company that has done evil to solve that evil. Further, this proposal arguably offers victims the greatest recovery by rejecting a rushed asset sale. The continued operation preserves value during a transition period. Over time, the residual stain evaporates, and the new corporation can conduct an auction in a more favorable bidding environment, ideally within three to five years. In other words, tainted assets are cleansed behind a philanthropy shield and sold after a value rebound. The public benefit model is preferable to a traditional reorganization because a simple rebranding will not address asset taint or harsh public scrutiny. My proposal helps a business reestablish its reputation among consumers and other disparate constituents whose buy-in is needed

²³ For example, in *Purdue*, a rushed auction was expected to produce ostensibly no recovery for victims. See *infra* Section III.B; see also Declaration of Michael Atkinson in Support of the Statement of the Official Committee of Unsecured Creditors in Support of Confirmation of the Sixth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors at 32, *In re* Purdue Pharma, L.P., 635 B.R. 26 (Bankr. S.D.N.Y. 2021) [hereinafter *Purdue UCC Plan Support Letter*] (explaining that, during the bankruptcy case, Purdue actively sought a potential acquirer of its assets; only one bidder was identified, and that bidder's offer was still too low to receive serious consideration).

²⁴ These trusts are designed to avoid exhausting all funds. Once the trust's administrators determine that the trust lacks sufficient funds to pay projected claims, distributions will invariably be reduced. Therefore, a situation could arise in which initial claimants receive eighty cents on the dollar for their claims, but future claimants receive virtually nothing. In that situation, the trust has not technically exhausted all funds, but I describe it as "failing."

to maximize enterprise value. Most important, victims are able to participate in a shareholder windfall if the reorganized company experiences strong postbankruptcy performance.

As I discuss in Part II, we are at the forefront of a developing trend. There are only a few cases so far—most notably *Purdue* and the bankruptcy of Johnson & Johnson's talc subsidiary—but more are emerging, including cases involving drug distributors who contributed to the opioid crisis, cell phone manufacturers who may have concealed the risks of extended phone use, and producers of tainted infant formula.²⁵

This Article seeks to make three contributions to the legal literature on mass torts and financial restructuring. Primarily, this Article is the first to identify scarlet-lettered companies and conceptualize the resolution complexity that these companies pose. Second, this Article offers the public benefit proposal, a comprehensive normative approach to improving recoveries for mass tort victims by assembling existing statutory options in an unprecedented construct. No statutory modifications or new pieces of legislation are necessary; this is one of the proposal's key features. Finally, the legal literature has overlooked the idea of scarlet-lettered companies and the need for alternative, value-preservation models. Mass tort bankruptcies present some of the most meaningful and challenging legal issues in the country today, but there is very little scholarship addressing these interdisciplinary disputes. I hope to engage scholars from various disciplines to explore improvements to and novel applications of my proposal.

This Article is divided into three Parts. Part I lays out the doctrinal framework for bankruptcy auctions and why this seemingly efficient process produces anomalous yields. Part II introduces the idea of scarlet-lettered companies and the unique social dynamics that bring criminals to justice but then ultimately eviscerate the value of the corporate assets necessary to compensate victims. Rushed auctions produce meager proceeds, raising the risk of a prematurely insolvent victims' trust and unsatisfied claims. Part III explores the public benefit proposal's details and ultimate utility. The proposal seeks to efficiently dispose of scarlet-lettered assets and thereby sufficiently fund the victims' settlement trust. To accomplish these two objectives, the proposal first envisions a deferred auction to create a delay premium that is allocated to victims. The second component is the creation of a public benefit corporation designed to secure stakeholder buy-in and cleanse tainted assets. Finally, the proposal embraces state law to impose rigorous governance safeguards designed to ensure fidelity to the new company's financial and societal goals.

²⁵ For more on each of these developing cases, see *infra* notes 104–106 and accompanying text.

In an age of greater personal and corporate accountability, I expect more scarlet-lettered companies landing in bankruptcy to address the disposition of tainted assets. My public benefit proposal offers a comprehensive normative approach designed to protect mass tort victims. In the aggregate litigation symphony, this Article represents the initial notes of a new movement.

I. BANKRUPTCY AUCTIONS AND ANOMALISTIC YIELD

Well into the twentieth century, leading economists argued that supply and demand forces determined sale outcomes.²⁶ If true, elaborate protocols would not increase the likelihood of revenue maximization in auctions.²⁷ In fact, attendant transaction costs could suppress the realized price in any given sale. In the 1960s, Professor William Vickrey and others began pushing back on this theory, exploring the game-theoretic aspects of auctions²⁸ and organizing theoretical studies to assess participant behavior and outcomes.²⁹ This research ultimately established that various sale features, including price levels, are materially affected by auction design.³⁰ Innovative protocols can enhance bidding and produce greater revenue.

Today, economic literature asserts that auctions—when designed properly—are the optimal means to secure the highest price for many asset classes.³¹ In the years since the first spectrum license auction,³² governments

²⁶ See, e.g., PAUL MILGROM, PRIZE LECTURES ON WILLIAM VICKREY: PROCURING UNIVERSAL SERVICE: PUTTING AUCTION THEORY TO WORK 383 (1996), https://www.nobelprize.org/uploads/2018/06/vickrey_lecture_milgrom.pdf [<https://perma.cc/UCS4-JDFP>]; see also GERARD DEBREU, THEORY OF VALUE: AN AXIOMATIC ANALYSIS OF ECONOMIC EQUILIBRIUM 43–47 (1959).

²⁷ See MILGROM, *supra* note 26, at 382–83 (explaining that neoclassical theory “implicitly assumes that the particular rules governing how bids and offers are combined to determine prices and allocations ultimately [have] no effect on market outcomes”).

²⁸ I use the term “auction” broadly to capture any process in which the specific terms of a proposed sale, including price, are invariably determined by a comparison of bids.

²⁹ See William Vickrey, *Counterspeculation, Auctions, and Competitive Sealed Tenders*, 16 J. FIN. 8, 8–9 (1961); James H. Griesmer, Richard E. Levitan & Martin Shubik, *Toward a Study of Bidding Processes Part IV—Games with Unknown Costs*, 14 NAVAL RSCH. LOGISTICS Q. 415, 415–16 (1967); Robert B. Wilson, *Competitive Bidding with Disparate Information*, 15 MGMT. SCI. 446, 446 (1969).

³⁰ See Vickrey, *supra* note 29, at 20–23.

³¹ Dirk Bergemann, Stephen Morris & Satoru Takahashi, *Efficient Auctions and Interdependent Types*, 102 AM. ECON. REV. 319, 319 (2012). Auction theory’s details are beyond this Article’s scope, but there are numerous instructive primers. See, e.g., VIJAY KRISHNA, AUCTION THEORY (2d ed. 2010); PAUL MILGROM, PUTTING AUCTION THEORY TO WORK (2004); Paul Klemperer, *What Really Matters in Auction Design*, 16 J. ECON. PERSPS. 169 (2002).

³² In the 1990s, economists put theory into practice. The Federal Communications Commission was given the authority to do something it had never done before: auction radio spectrum licenses. Peter Cramton, *The Efficiency of the FCC Spectrum Auctions*, 41 J.L. & ECON. 727, 727–28 (1998). The agency sought a value-maximizing design for these sales and approached Professors Robert Wilson and Paul

have embraced auction theory and now regularly employ bespoke auctions to allocate a panoply of assets, including licenses, marketable securities, mineral rights, oil and gas leases, timber rights, and electricity production.³³ A significant body of auction literature has developed around these types of sales. But auction theory's basic principles apply in many other contexts, including asset sales in bankruptcy.

Bankruptcy scholars have similarly embraced the idea of auction utility, touting Section 363(b) asset sales as a market alternative to judicial valuation.³⁴ These sales have become the predominant means of disposing of assets³⁵ in corporate bankruptcy.³⁶ In the early 2000s, asset-sale frequency increased dramatically.³⁷ Some scholars recognized the new trend and the possibility that asset sales were optimal.³⁸ Scholars argued that these sales were frequently preferable to resource-intensive Chapter 11 reorganizations that relied on the debtor convincing key stakeholders to support a revised business model.³⁹

Milgrom for optimal auction protocols. The resultant auction and many others that would follow were wildly successful, spawning a robust canon of auction scholarship. See MILGROM, *supra* note 26, at 383.

³³ See, e.g., Paul R. Milgrom & Robert J. Weber, *A Theory of Auctions and Competitive Bidding*, 50 *ECONOMETRICA* 1089 (1982) (securities); Christopher N. Osher, *Federal Plan to Auction Mineral Rights near Great Sands Dunes National Park Opposed by Environmentalists*, DENVER POST (Mar. 9, 2018), <https://www.denverpost.com/2018/03/09/great-sand-dunes-national-park-mineral-rights-auction/> [<https://perma.cc/6837-97LM>] (minerals); Oliver Milman, *US Auctions Off Oil and Gas Drilling Leases in Gulf of Mexico After Climate Talks*, GUARDIAN (Nov. 17, 2021), <https://www.theguardian.com/us-news/2021/nov/17/biden-administration-gulf-of-mexico-oil-gas-drilling-leases> [<https://perma.cc/MCZ6-BV7L>] (oil and gas); Colin Doran & Thomas Stratmann, *The Effects of Neighboring Parties on the Value of Rights: Evidence from Timber Harvests*, 88 *S. ECON. J.* 705, 711–13 (2021) (timber); Hughes v. Talen Energy Marketing, 578 U.S. 150, 154–57 (2016) (electricity).

³⁴ See *supra* note 22 and accompanying text; see also Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 *YALE L.J.* 862, 889 (2014); 11 U.S.C. § 363(b).

³⁵ This Article discusses the sale of “assets.” That term captures all types of property, including personal, real, and intellectual, as well as entire going-concern businesses.

³⁶ See Yaad Rotem & Omer Dekel, *The Bankruptcy Auction as a Game—Designing an Optimal Auction in Bankruptcy*, 32 *REV. LITIG.* 323, 325 (2013).

³⁷ See FLORIDA-UCLA-LOPUCKI BANKR. RSCH. DATABASE, https://lopucki.law.ufl.edu/design_a_study_percent_by_year.php [<https://perma.cc/6PCS-39DU>] (showing only six auctions involving large public companies in the 1980s, but over 140 in the period from 2000 to 2010). Naturally, most bankruptcy asset sales do not involve large public companies, but the spike in auction popularity was realized across corporate debtor types.

³⁸ See Baird & Rasmussen, *Chapter 11*, *supra* note 22, at 674–78; Baird & Rasmussen, *Bankruptcy*, *supra* note 22, at 751; see also JACKSON, *supra* note 22, at 223.

³⁹ See Baird & Rasmussen, *Chapter 11*, *supra* note 22, at 674–78; Baird & Rasmussen, *Bankruptcy*, *supra* note 22, at 751.

Despite this prominence, there is limited bankruptcy scholarship that explores auction design,⁴⁰ and virtually no scholarship considering the sale of volatile assets or alternative disposition measures when neither an auction nor the traditional reorganization process is optimal for an otherwise-valuable entity. Muted in the current discussion is the fact that the ubiquitous bankruptcy auction is rarely efficient⁴¹ and frequently the worst option available.

A. Auction Mechanics and Benefits

Bankruptcy architecture provides three primary resolution options for corporate debtors. A debtor can restructure its business by using the Bankruptcy Code's various forms of relief and emerge as a reorganized entity, usually with a new ownership group, business model, and capital structure. A debtor may also sell its business as a going concern through Section 363 of the Code or a plan of reorganization. Finally, a debtor can terminate its business and liquidate valuable parts. For the last two options, sale proceeds are used to address creditor claims.⁴²

In order to maximize proceeds, bankruptcy auctions must minimize transaction costs and facilitate active bidder participation.⁴³ The debtor who

⁴⁰ There are a few bankruptcy scholars that explore the issue. *See, e.g.*, Philippe Aghion, Oliver Hart & John Moore, *Improving Bankruptcy Procedure*, 72 WASH. U. L.Q. 849, 861–63 (1994); Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 73–74 (1991). But recent scholarship invariably focuses on a secured creditor's ability to "credit bid" its claim at the auction. *See infra* note 76; Alan N. Resnick, *Denying Secured Creditors the Right to Credit Bid in Chapter 11 Cases and the Risk of Undervaluation*, 63 HASTINGS L.J. 323, 329 (2012); Vincent S. J. Buccola & Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99, 100 (2010). Economics literature has been far more active in exploring bankruptcy auction design. *See, e.g.*, Jordan B. Neyland & Kathryn A. St. John, *Hidden Wealth Transfers in Bankruptcy Asset Sales: A Real Option Analysis*, 19 BERKELEY BUS. L.J. 46 (2022); Rotem & Dekel, *supra* note 36, at 327; Sugato Bhattacharyya & Rajdeep Singh, *The Resolution of Bankruptcy by Auction: Allocating the Residual Right of Design*, 54 J. FIN. ECON. 269, 270 (1999).

⁴¹ Many economists describe an auction as being "efficient" when an asset is transferred to the bidder who values that asset the most. This perspective is particularly useful in cases of privatization—when a state-owned asset is being sold into the private sector. In these cases, an allocation may be "efficient" even if an alternative auction process would have produced a higher realized price. *See* Partha Dasgupta & Eric Maskin, *Efficient Auctions*, 115 Q.J. ECON. 341, 341–42 (2000). However, the idea of an "efficient" auction has evolved differently in bankruptcy. The Creditors' Bargain is one of the foundational theories of bankruptcy and provides, in part, that the ultimate process goal is to maximize the distribution to the creditor collective. Thomas H. Jackson, *Bankruptcy, Non-bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 860 (1982); *see also* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 836–43 (1985). This Article adopts this perspective. Consequently, as used here, a bankruptcy auction is "efficient" if it is unlikely that an alternative choice would produce a higher realized price and increased distribution to creditors.

⁴² *See* LoPucki & Doherty, *supra* note 22, at 5.

⁴³ *See* Rotem & Dekel, *supra* note 36, at 364–66.

believes that an asset sale will produce the greatest value for the estate is tasked with preparing auction protocols, which will include some procedures that are characteristic of almost every auction and some that are peculiar to bankruptcy. The key auction facets are the identity of the stalking-horse bidder and the initial bid price.⁴⁴ Auction protocols will also provide overbid requirements, diligence periods, qualifying procedures for other bidders, and the break-up fee owed to the stalking-horse bidder if that party is not chosen as the auction's winner. The debtor is tasked with establishing the auction format, but an ascending-bid auction is always chosen.⁴⁵

A bankruptcy auction is extremely attractive in theory. The process offers an accelerated redeployment of the debtor's assets through an ostensibly free market process that requires limited court involvement.⁴⁶ Bankruptcy auctions impose numerous rules, but the clear structure is intended to reduce transaction costs and encourage bidder entry.⁴⁷ The auction can involve one asset or an entire going concern. Bolstering the process is the fact that the sale cuts off legacy liability; assets are sold free and clear of liabilities and other interests.⁴⁸

As noted above, the debtor is tasked with formulating the bidding procedures. Once approved by the bankruptcy court, these procedures are rarely subject to revision, and the seller cannot arbitrarily halt the process.⁴⁹ Bankruptcy auctions—some of which involve multibillion-dollar corporations—can occur just a few months after the bankruptcy filing. This accelerated timeline can be extremely valuable when a company is

⁴⁴ The stalking-horse bidder is a party that evaluates the assets prior to the auction and agrees with the debtor to purchase the assets at the initial bid price. *Id.* at 341.

⁴⁵ For more on ascending-bid auctions, or “English” auctions, see *infra* Section I.B.1.a.

⁴⁶ See generally JACKSON, *supra* note 22, at 219 (explaining that robust capital markets enhance the efficiency of bankruptcy asset sales); Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 128 (1986) (touting bankruptcy asset sales as a market redeployment with limited bankruptcy court involvement).

⁴⁷ We see this dynamic in various contexts, including highly regulated markets. For example, in commodity exchanges, the rules put in place may appear to restrain participation, but in fact help to reduce transaction costs and ultimately increase trading volume. See R.H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 9–10 (1988). Bankruptcy auction design is informed by lessons in these contexts.

⁴⁸ See Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 737 (2019) (explaining how bankruptcy courts have permitted “the extinction not only of in rem interests, such as security interests and mortgages, but also personal liability under successor liability theories”); Baird & Rasmussen, *Bankruptcy*, *supra* note 22, at 786–87 (noting that “[s]everal obstacles stand in the way” of cutting off legacy liability outside of bankruptcy).

⁴⁹ See generally Rotem & Dekel, *supra* note 36, at 348 (“Everybody knows that the auction is run under a deadline and cannot be postponed.”). Outside of bankruptcy, directors' fiduciary duties compel them to abandon negotiations in the event they receive a higher bid from another party. See, e.g., Randall S. Thomas & Robert G. Hansen, *A Theoretic Analysis of Corporate Auctioneers' Liability Regimes*, 1992 WIS. L. REV. 1147, 1156–57 (1992).

deteriorating rapidly.⁵⁰ Speed preserves value in these cases, and this speed premium can be allocated to creditors instead of dissipating as a contested case languishes. Speed also helps reduce administration costs and avoids funds unnecessarily going to attorneys and other professionals managing the bankruptcy case.⁵¹

With judicial approval, the auction can occur outside the debtor's ordinary course of business and without creditor consent. There are few creditor protections, and auctions can proceed if the court determines that a valid business justification supports the sale.⁵² The bankruptcy court's involvement engenders certainty.⁵³ And the ruling approving the sale is invariably final. Unlike other court processes, the bankruptcy code provides that a sale of assets is unaffected by an appellate court reversing or modifying the auction ruling as long as the winning bidder was found to have acted in good faith and the sale was not stayed by the bankruptcy court pending

⁵⁰ Jacoby & Janger, *supra* note 34, at 862.

⁵¹ See, e.g., Jacob A. Kling, *Rethinking 363 Sales*, 17 STAN. J.L. BUS. & FIN. 258, 260 (2012) (stating that “[f]rom an efficiency perspective, such 363 sales offer a number of advantages over a traditional reorganization”).

⁵² Auctions are unaffected by the extensive creditor protections mandated in the plan confirmation process. See Elizabeth B. Rose, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEVS. J. 249, 250, 256–57 (2006). Many of the customary creditor safeguards we see in a plan process do not exist in a Section 363(b) sale or are often disregarded. See, e.g., *In re Chrysler LLC*, 576 F.3d 108, 114 (2d Cir. 2009) (“[A] § 363(b) sale might evade such requirements as disclosure, solicitation, acceptance, and confirmation of a plan.”).

⁵³ See, e.g., R. Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. ECON. LITERATURE 699, 703–04 (1987) (explaining that institutions like courts of law can add value to the auction process by, at the very least, preventing parties from renegeing on auction commitments).

appeal.⁵⁴ Sale proceeds are distributed to creditors pursuant to prebankruptcy entitlements.⁵⁵

Section 363 promises a distressed company the possibility of separating valuable assets from attendant debts and liabilities while relying on the Bankruptcy Code and a bankruptcy judge to determine how proceeds should be allocated.⁵⁶ However, amidst all these valuable features, structural and procedural deficiencies plague the process and suppress creditor recoveries in many cases.

B. Auction Infirmities

Despite being an extremely popular option for debtors, bankruptcy auctions are often inefficient. In their seminal article *Bankruptcy Fire Sales*, Professors Lynn LoPucki and Joseph Doherty compared recoveries in bankruptcy cases that auctioned a going concern with those relying on a restructuring through a plan of reorganization.⁵⁷ Their results revealed a negative correlation between Section 363 sales and creditor recoveries.⁵⁸ In fact, when controlling for the differences in the prefiling earnings of the two sets of companies from 2000 to 2004, asset sales yielded less than half as

⁵⁴ One potential disadvantage of a court-supervised process is that a party in interest could appeal the ruling confirming the auction winner, and the ultimate transfer of the assets could be delayed years while the matter meanders through the appellate process. This risk is minimized in bankruptcy. Section 363(m) provides that a sale of assets is unaffected by an appellate court reversing or modifying the auction ruling as long as the winning bidder was found to have acted in good faith and the sale was not stayed by the bankruptcy court pending appeal. *See* 11 U.S.C. § 363(m); Alla Raykin, *Section 363 Sales: Mooting Due Process?*, 29 EMORY BANKR. DEVS. J. 91, 93–94 (2012).

Naturally, there are exceptions. For example, on December 1, 2021, Limetree Bay Services, LLC—a Chapter 11 debtor-in-possession—designated St. Croix Energy as the auction winner. Shortly thereafter, Limetree asked the bankruptcy court to reopen the auction. The debtor argued that the CEO of West Indies Petroleum (WIP) experienced a medical emergency, and WIP was unable to timely submit bid documents. The court granted the request and held a new auction, which WIP won. *See* Rick Archer, *Losing Bidder Says Limetree Reopened Sale on False Premise*, LAW360 (Dec. 20, 2021, 7:32 PM), <https://www.law360.com/articles/1450543/losing-bidder-says-limetree-reopened-sale-on-false-premise> [<https://perma.cc/2P58-FXRH>]. For another example, see Alex Wolf, *'The One' Mansion Can Seek Higher Offers After \$141 Million Bid*, BLOOMBERG L. (Mar. 14, 2022, 1:14 PM), <https://news.bloomberglaw.com/bankruptcy-law/the-one-mansion-can-seek-higher-offers-after-141-million-bid> [<https://perma.cc/8RV5-JXLG>].

⁵⁵ *See* Rotem & Dekel, *supra* note 36, at 343.

⁵⁶ *See* Bhattacharyya & Singh, *supra* note 40, at 270 (explaining that the auction allows the debtor to separate the question of how best to maximize asset value from the one of how best to allocate this value among creditors).

⁵⁷ LoPucki & Doherty, *supra* note 22, at 6–11.

⁵⁸ *Id.* at 37.

much value as reorganizations.⁵⁹ Scholars promptly attacked these findings,⁶⁰ but recent research has supported them.⁶¹ How can the optimal means to secure the highest price for most assets produce such woefully deficient outcomes in bankruptcy?

1. *Entry Deterrence and Collusion Risk in Bankruptcy Auctions*

Auction efficiency is undermined by many factors that coalesce to amplify entry deterrence and collusion. As explored in this Section, entry deterrence occurs when auction dynamics dissuade bidders from incurring the transaction costs necessary to participate. This phenomenon is troubling because it often results from some level of party manipulation.

Realized prices at auction tend to increase as more bidders appear.⁶² The addition of each new bidder increases the probability of a higher realized price.⁶³ Consequently, various parties are incentivized to obstruct entry. We see limited bidders in bankruptcy. This thin market is the result of intentional and unintentional design choices. Furthermore, repeat-player dynamics in bankruptcy increase the risk that parties will collude to avoid bidding up prices. This collusion can involve parties interested in winning an auction at a certain price or insiders seeking to secure ex post benefits.

a. *Auction design*

Auction design cannot be “one size fits all.”⁶⁴ Rather, design should evolve based on context and actors. A distorted auction design can suppress revenue maximization in ways that are easily overlooked. Bidding format is

⁵⁹ See *id.* at 3–4.

⁶⁰ See James J. White, *Bankruptcy Noir*, 106 MICH. L. REV. 691, 692 (2008) (relying on selection bias and other errors to discredit LoPucki and Doherty’s findings). See generally Jeremy Murphy, *Bankruptcy Avant-Garde*, 19 AM. BANKR. INST. L. REV. 113, 123–24 (2011) (relying on an options pricing model to argue that the difference in recoveries identified by LoPucki and Doherty has marginal significance).

⁶¹ Samuel Antill, *Do the Right Firms Survive Bankruptcy?*, 144 J. FIN. ECON. 523, 535–36 (2022) (noting that rushed bankruptcy auctions that occur without creditor approval produce diminished creditor recoveries compared to comparable reorganizations); Anne M. Anderson & Yung-Yu Ma, *Acquisitions in Bankruptcy: 363 Sales Versus Plan Sales and the Existence of Fire Sales*, 22 AM. BANKR. INST. L. REV. 1, 2 (2014) (finding that Section 363 sales are associated with lower realized prices compared with sales that occur through a plan of reorganization); see also Julian Franks, Gunjan Seth, Oren Sussman & Vikrant Vig, *Revisiting the Asset Fire Sale Discount: Evidence from Commercial Aircraft Sales* (Eur. Corp. Governance Inst., Working Paper No. 722/2021, 2021) (analyzing sales of aircraft by distressed airlines to acknowledge fire-sale discounting but arguing that inefficiencies associated with fire sales are likely to be less prevalent than previously documented).

⁶² See Jeremy Bulow & Paul D. Klemperer, *Auctions Versus Negotiations*, 86 AM. ECON. REV. 180–94 (1996); see also Buccola & Keller, *supra* note 40, at 119–20 (arguing that allowing interested buyers with “sufficient financial means to participate in the auction” may maximize sale proceeds); Paul Klemperer, *Auction Theory: A Guide to the Literature*, 13 J. ECON. SURVS. 227, 239 (1999).

⁶³ See Klemperer, *supra* note 62, at 239.

⁶⁴ See, e.g., Klemperer, *supra* note 31, at 184.

one of the most important facets of auction design. There are four primary types. The most common design is the ascending-bid or “English” auction.⁶⁵ In an English auction, the auctioneer announces the seller’s reservation price and then qualified bidders have the opportunity to overbid this amount, usually pursuant to preestablished increments. The bidder with the highest bid price is invariably the winner of the auction.

An English auction is the only format used in bankruptcy, but the reason for that exclusive use is unclear, and appears to represent a historical anomaly. Neither the Bankruptcy Code nor court rules mandate this format or even advise on auction design.⁶⁶ The fact that bankruptcy auctions default to this format is odd. Economic literature establishes that the English model will not be optimal in all—or perhaps even most—asset sales.⁶⁷ For example, imagine a scenario in which one bidder (Bidder A) values the assets being sold more than do other bidders. Bidder A’s reservation price⁶⁸ is \$100. Assume there are five other bidders but none with a reservation price above \$50. Furthermore, assume an ascending-bid auction with incremental bidding, limited signaling across the bidder group, and bidders behaving competitively. The five other bidders will presumably stop bidding once the price crosses the \$50 threshold. Bidder A will win the auction with a bid as low as \$51. The seller has lost out on the \$49 spread between the realized price and Bidder A’s reservation price.

⁶⁵ The descending-bid or “Dutch” auction is a second type. In a Dutch auction, the auctioneer announces a price generally considered to be above the fair market value of the asset for sale and then incrementally drops the price until a prequalified bidder agrees to pay the announced price and halt the auction. Klemperer, *supra* note 62, at 229. A sealed-bid auction is common in sales conducted by government entities. *See id.* at 266 n.14. In a sealed-bid auction, each bidder submits its highest and best offer in a sealed envelope. All envelopes are opened concurrently and the bidder with the highest bid is the winner of the auction. *Id.* at 229. Finally, Professor Vickrey pioneered the second-price auction, which is identical to the sealed-bid auction except that the amount paid by the highest bidder is not the amount listed in the highest bid, but the amount listed in the second-highest bid. *Id.*

⁶⁶ For example, Delaware bankruptcy courts are considered the most prominent bankruptcy courts in the country. *See* Jeffrey P. Fuller, *Analysis: Three Bankruptcy Courts Remain Top Megacase Magnets*, BLOOMBERG L. (Dec. 17, 2021, 4:00 AM), <https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-three-bankruptcy-courts-remain-top-megacase-magnets> [https://perma.cc/4SY3-3FL4]. Delaware’s local bankruptcy rules afford the debtor discretion to establish the bidding format that it believes will maximize revenue. *See* BANKR. D. DEL. R. 6004-1(c). The rules allow for an ascending-bid auction, but that format is not mandated. The local rules for New York bankruptcy courts do not mention auction design.

⁶⁷ *See, e.g.*, Klemperer, *supra* note 31, at 184.

⁶⁸ The bidder’s reservation price—or reserve price—is the highest price the bidder is willing to pay for the assets. The seller’s reservation price is the lowest price the seller will accept for the assets. *See* Ian Steedman, *Reservation Price and Reservation Demand*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS* 11586, 11586 (Kenneth Arrow et al. eds., 3d ed. 2018).

The harm goes further. We know that a potential bidder is deterred from bidding when she believes her chances of winning are low.⁶⁹ In a traditional ascending-bid auction, bidders understand that the process provides an advantage to a resource-rich bidder with a relatively high reservation price. Consequently, the resource-poor bidder may choose to avoid the transaction costs inherent in participating in what may seem like a doomed endeavor.⁷⁰ Fewer bidders raise the probability that the auction's realized price may be lower than \$51.⁷¹

Further complicating matters, the public nature of the bankruptcy process allows bidders to engage in predation, a tactic where Bidder A sends signals to other potential bidders that they should not incur the transaction costs necessary to enter the auction because Bidder A is prepared to overpay for the assets or enjoys some sort of informational advantage.⁷² This problem is amplified because bankruptcy auctions rely heavily on a stalking-horse bidder, a party that has presumably evaluated the assets and agreed to purchase those assets at a price that will ultimately be the initial bid in the upcoming auction. Stalking-horse bidders are rare in most auctions outside

⁶⁹ See Rotem & Dekel, *supra* note 36, at 368.

⁷⁰ Significant transaction costs plague the bid-preparation process. See Matthew Kapitanian & Ryan J. Dattilo, *A Sotheby's 363 Sale: Lessons Learned from the Auction Experts*, 25 NORTON J. BANKR. L. & PRAC. 1, 3 (2016) (first citing Peter Cramton & Alan Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J.L. ECON. & ORG. 27, 30 (1991); and then citing Rotem & Dekel, *supra* note 36, at 364). Assembling a team of professionals to properly assess the assets and then formulate a bidding strategy is costly.

⁷¹ Cf. Bulow & Klemperer, *supra* note 62, at 185–86 (“[A]n auction with $N + 1$ bidders and no reserve price is more profitable than any standard mechanism with N bidders.”). One simple solution is for debtors to consider an alternative format. The debtor could pursue a descending-bid auction in which the court would set a price for the auction to begin, and the first bidder to accept a stated price would be the winner. I acknowledge that descending-bid auctions are extremely foreign in bankruptcy, so a hybrid model may be ideal. Ultimately, the “Anglo-Dutch” hybrid combines an ascending-bid process with a sealed-bid auction, see Rotem & Dekel, *supra* note 36, at 384–85, and is common in many government auctions. A typical “Anglo-Dutch” auction starts as an ascending-bid auction and is run until only two bidders remain. The two remaining bidders are then required to make a final sealed-bid offer that is not lower than the current price. The auction's winner is the one who submits the highest sealed bid. Assume we have Bidder A, with a reservation price of \$100; and Bidder B, with a reservation price of \$75. Further assume that these two bidders are the only ones who remain after a few rounds in the initial ascending-bid auction. At that point, both remaining bidders are invited to submit a sealed bid. Bidder A has a much higher reservation price but can no longer play along until Bidder B hits its reservation price. Bidder A will need to make a final bid without complete information regarding Bidder B's reservation price. Assuming Bidder B has not signaled its relatively weaker position, there is a strong possibility that Bidder A will approach its reservation price, allowing the estate to capture the spread between Bidder B's reservation price and the realized price, which should approximate Bidder A's reservation price. Note that this hybrid model adds a level of unpredictability to the proceedings and may encourage robust bidder entry. After all, Bidder A may underbid in its final sealed bid.

⁷² See Klemperer, *supra* note 31, at 174.

of bankruptcy but are an absolute fixture inside of bankruptcy.⁷³ Stalking-horse bidders can help draw other bidders—especially those interested in free riding on the diligence performed by a seemingly competent competitor—to an auction. However, economic literature has demonstrated that a diminished realized price is often an overlooked risk of an auction in which one bidder has an initial stake.⁷⁴

One form of predation in bankruptcy is the signal that the stalking-horse bidder has had additional time to perform due diligence and, in light of the extremely truncated timelines provided to other bidders, will enjoy an informational advantage. A corollary to this premise is that the stalking-horse bidder—because of this informational advantage—is better situated to assess asset value and avoid unnecessary discounting in formulating its reservation price.⁷⁵ The ultimate result is the likelihood that the stalking-horse bidder will have a far higher reservation price than other bidders. The sales procedures also afford the stalking-horse bidder other perks, including a breakup fee worth between 1% and 3% of the ultimate realized price in the event the stalking-horse bidder does not win the auction.⁷⁶

In bankruptcy, the mix of poor design, predation, and information asymmetries all work to chill bidding.⁷⁷ A strong signal dissuades bidders

⁷³ In fact, a stalking-horse bidder is seen as an essential part of the auction, and an auction without one at the outset will be predicted to fail. *See* White, *supra* note 60, at 708.

⁷⁴ *See, e.g.*, Edith S. Hotchkiss & Robert M. Mooradian, Auctions in Bankruptcy 3–5 (July 1999) (unpublished manuscript), <https://ssrn.com/abstract=161990> [<https://perma.cc/VRC7-ES3S>] (discussing how the potential of overbidding by bidders with an initial stake can deter other bidders from entering the contest, resulting in an uncompetitive auction).

⁷⁵ *See* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1246 (2006).

⁷⁶ A secured creditor who is credit bidding is another party that deters entry in many cases. A secured creditor is entitled in bankruptcy to credit bid the face value of its debt at the auction of the asset on which it has a senior lien. Assume that the debtor owes its secured creditor \$10,000, and the creditor has a properly perfected lien on the debtor's sole asset, which is to be sold in bankruptcy. The creditor has a right to credit bid the \$10,000 it is owed; in other words, it doesn't need to provide any cash to win the auction as long as the price does not exceed \$10,000. A bidder who intends to bid less than \$10,000 knows that the secured creditor can easily outbid it. A secured creditor is also extremely familiar with the auctioned assets, which may provide it an informational advantage that could similarly deter bidder entry. *See* Buccola & Keller, *supra* note 40, at 120; *see also In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292, at *4 (Bankr. E.D. Pa. Oct. 8, 2009) (recognizing the debtor's argument that the court should preclude credit bidding because it was likely to chill competitive bidding).

⁷⁷ In some cases, individuals serving in key executive or board roles with the debtor work with third-party bidders seeking to purchase the auctioned assets. *See* Douglas G. Baird, *Revisiting Auctions in Chapter 11*, 36 J.L. & ECON. 633, 635 (1993). This dynamic exacerbates the fear of information asymmetries and also chills bidding.

from incurring the transaction costs necessary to be a legitimate threat, creating anomalous yields in many cases.⁷⁸

b. Bidder collusion, intermediary conflict, and the threat of punishing rivals

Debtors-in-possession (DIP), stalking-horse bidders, and legal and financial professionals, as well as other interested parties, frequently dissuade potential bidders from participating in auctions. We see this problem both inside and outside of bankruptcy. In a recent article, Professors Guhan Subramanian and Annie Zhao explain how conflicts of interest and similar dynamics cause investment bankers and other professional intermediaries to favor certain buyers at the expense of revenue maximization.⁷⁹ The problem is more pronounced in bankruptcy because of the insular community of professionals that dictate outcomes in these cases.

The recent Neiman Marcus bankruptcy offers an example. Daniel Kamensky was the founder of distressed-debt hedge fund Marble Ridge Capital and served on the creditors' committee in the Neiman Marcus case. As a committee member, Kamensky acted as a fiduciary to the creditors the committee represented. As part of a settlement between the creditors' committee and the bankruptcy estate, 140 million Series B shares of Neiman Marcus's subsidiary, MyTheresa, were allocated to the creditors' committee.⁸⁰ In an effort to liquidate the shares, the committee solicited bids. Marble Ridge submitted a proposal to buy up to 60 million shares at twenty cents on the dollar. Jefferies, a prominent investment bank of which Marble Ridge was a client, contacted the committee's financial advisor and indicated that it would be submitting a bid that was substantially higher than twenty cents on the dollar. Upon learning of this new competitor, Kamensky sent Joe Femenia, the head of distressed-debt trading at Jefferies, a text message: "Do Not Send in a Bid."⁸¹ In a subsequent call with individuals from Jefferies, Kamensky demanded that Jefferies not submit a competing bid. Marble Ridge was a valuable Jefferies client, and Kamensky indicated that he could pull his hedge fund's business if the bank moved forward. Jefferies ultimately withdrew its bid but informed counsel for the creditors' committee of Kamensky's role in engineering that result. Kamensky was arrested on

⁷⁸ See LoPucki & Doherty, *supra* note 22, apps. A-1, A-2 (collecting cases comparing outcomes in asset sales and reorganizations).

⁷⁹ See Guhan Subramanian & Annie Zhao, *Go-Shops Revisited*, 133 HARV. L. REV. 1215, 1253–54 (2020).

⁸⁰ See Amanda Cantrell, *In Five Hours, Daniel Kamensky Destroyed His Career. Why?*, INSTITUTIONAL INV. (Sept. 16, 2020), <https://www.institutionalinvestor.com/article/b1nds3878fmg7/In-Five-Hours-Daniel-Kamensky-Destroyed-His-Career-Why> [<https://perma.cc/67RL-QC4K>].

⁸¹ See *id.*

September 3, 2020, and charged with fraud, extortion, and obstruction of justice.⁸² He pled guilty and was sentenced to six months in prison.⁸³ Kamensky's conduct was illegal regardless of his role in the case but was particularly egregious because he was a creditor representative tasked with pursuing the highest value for the MyTheresa shares.

Though this event occurred outside the typical auction process, it is representative of bidder dynamics in many bankruptcy cases.⁸⁴ Bankruptcy's repeat-player model discourages institutions and professionals with deep financial connections from behaving competitively in relatively small-stakes auctions that could sour multimillion-dollar relationships.⁸⁵

Another form of collusion is fueled by bankruptcy's unique principal-agent problem. Corporate bankruptcy cases are managed by the debtor's executives. Most of these individuals do not have guaranteed employment prospects once the bankruptcy case closes. Consequently, these insiders—who are tasked with making key resolution decisions—are subject to governance mismatch⁸⁶ and prone to self-interested conduct that may be detrimental to all stakeholders. More specifically, there are numerous cases

⁸² *Id.*

⁸³ See Soma Biswas, *Hedge-Fund Founder Kamensky Gets Prison Sentence for Fraud Tied to Neiman Bankruptcy*, WALL ST. J. (May 7, 2021), <https://www.wsj.com/articles/neiman-marcus-foe-kamensky-sentenced-to-six-months-in-prison-for-bankruptcy-fraud-11620405322> [<https://perma.cc/2L7R-2C3D>].

⁸⁴ Another example is the Caesars bankruptcy case. Executives at Apollo, the equity sponsor of the debtors, made calls to pressure key executives at Oaktree, a creditor in the case who was standing in the way of a settlement Apollo sought. See MAX FRUMES & SUJEET INDAP, *THE CAESARS PALACE COUP: HOW A BILLIONAIRE BRAWL OVER THE FAMOUS CASINO EXPOSED THE POWER AND GREED OF WALL STREET 122* (2021). “Apollo had . . . a gift for preying on the pain points of its adversaries. Apollo ominously reminded them that Oaktree and [other key creditors] depended on deal flow from Apollo that they could be excluded from in the future.” *Id.*

Further examples abound. See Alex Wolf, *Jay Alix's RICO Suit Against McKinsey Revived on Appeal (I)*, BLOOMBERG L. (Jan. 19, 2022, 1:28 PM), <https://news.bloomberglaw.com/bankruptcy-law/jay-alixs-racketeering-suit-against-mckinsey-revived-on-appeal> [<https://perma.cc/D7DP-FNZZ>] (explaining allegations that McKinsey & Co., the restructuring advisory firm, concealed blatant conflicts of interest in thirteen large corporate bankruptcies in order to secure lucrative bankruptcy work); see also Jared A. Elias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 752–57 (2020) (detailing how relationship dynamics distort decision-making for financially distressed entities); Rotem & Dekel, *supra* note 36, at 347 (explaining how the prospect of future business and existing relationships could entice professionals to contravene ethical and professional obligations in facilitating sales to particular bidders).

⁸⁵ See *supra* note 75.

⁸⁶ See Samir D. Parikh, *Bankruptcy Tourism and the European Union's Corporate Restructuring Quandary: The Cathedral in Another Light*, 42 U. PA. J. INT'L L. 205, 265 (2020) (“Directors, senior officers, and other insiders – who are invariably shareholders as well and receive variable compensation based on company performance – share in the prosperity of the company for which they work. During times of corporate profitability, these insiders . . . suppress self-interested conduct to the extent that it creates a material risk of harm to their employer. However, once a subject company becomes insolvent, it is often disadvantageous for insiders to suppress their self-interested conduct.”).

of key decision-makers seemingly ignoring revenue maximization in order to facilitate a sale to a “white knight” buyer willing to offer ex post employment and other opportunities.⁸⁷ We can return to the Neiman Marcus bankruptcy for another example. A key creditor in that case alleged that the debtor’s management team had signed a restructuring support agreement with influential creditors and ultimately eschewed a seemingly value-maximizing merger with Saks Fifth Avenue because the alternative did not provide these insiders with guaranteed postsale employment.⁸⁸

2. *Bullying Creditors and Court Heuristics*

A significant part of bankruptcy architecture is the idea of a debtor’s prebankruptcy management team running the company in bankruptcy for the benefit of creditors. As noted above, self-interested conduct is an ever-present fear. The principal–agent problem in bankruptcy has another facet: management may be too influenced by the demands of some creditors and willing to ignore others. Indeed, the debtor-in-possession is invariably reliant on at least one prominent creditor who has agreed to fund the bankruptcy case. Furthermore, there are groups of key creditors without whom the debtor has little chance of constructing a successful exit.⁸⁹ These parties are able to influence management in unforeseen ways.

The result is that these and other bullying creditors render debtors tolerant of sales that are inefficient.⁹⁰ Even in cases where it is likely that a deferred sale will provide more value than a rushed sale, key creditors will push for a rushed sale.⁹¹ Hoping to capture the speed premium, bankruptcy auctions are frequently accelerated and continue despite concerns about realized price. Regardless of periods of economic downturns, illiquidity in the credit markets, or industry-specific distress, disposition may be pursued because of the fear that further erosion in asset value awaits the patient debtor. As noted above, the simple premise is that there is a speed premium

⁸⁷ See *In re River Rd. Hotel Partners, LLC*, 651 F.3d 642, 651 n.6 (7th Cir. 2011) (“[T]here is an inherent risk of self-dealing on the part of existing management [overseeing auctions]. We have recognized that existing management may have an incentive to favor ‘white knight’ bidders favorably disposed to preserving the existing business over others who might enter higher bids.”); Rose, *supra* note 52, at 278 (“Management rewards played a significant role in Polaroid’s bankruptcy § 363 preplan business sale.”); see also Kenneth Ayotte & Jared A. Elias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. 1, 4–5 (2022); Antill, *supra* note 61, at 525 n.9; Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 538–39 (2009) (questioning the motivations of managers and equity holders as they relate to the interests of other parties to a bankruptcy).

⁸⁸ See Ayotte & Elias, *supra* note 87, at 4–5, 5 n.11.

⁸⁹ See Ayotte & Morrison, *supra* note 87, at 512; cf. Ayotte & Elias, *supra* note 87, at 3–4 (explaining how DIP loan contracts may sometimes constitute a “significant transfer of control” to creditors in the bankruptcy process).

⁹⁰ Rotem & Dekel, *supra* note 36, at 346–47.

⁹¹ See Neyland & St. John, *supra* note 40, at 56.

created by expeditiously selling off a distressed company, and senior creditors—the parties invariably pushing for the asset sale—will be allocated that premium.

In a new paper, Professors Jordan Neyland and Kathryn St. John use a call-option analogy to demonstrate that creditors exhibit a strong preference to pursue early sales, even with significant risks of diminished yield and “when such assets are not depreciating or otherwise declining in value.”⁹² These creditors invariably believe they have little to gain from postponing auctions in an attempt to find a more favorable bidding environment.⁹³ And these bullying creditors, including secured lenders and DIP loan financiers, have enough leverage in these cases to dictate outcomes.⁹⁴ Indeed, they are willing to fund the case to an accelerated auction but not beyond that point. But the harm from failed auctions affects parties well below the bullying creditors’ tier.

Court heuristics complicate these dynamics. Jurists incorrectly assume that bankruptcy auctions allow assets to be exposed to an efficient market and the winning bid in such a process must represent an approximation of fair market value, at the very least.⁹⁵ But auction processes with material design flaws rarely yield fair market value, and rushed sales may cause the estate to miss a value rebound. Further, as highlighted by Professors LoPucki and Doherty, a party capable of supplying the capital needed to purchase a large corporation out of bankruptcy in a rushed sale will “demand a substantial return on investment.”⁹⁶ In other words, this buyer would demand fire-sale prices.

⁹² See *id.* at 81.

⁹³ See Anthony J. Casey, *The Creditors’ Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 761 (2011); cf. Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 173–74 (2005) (stating that controlling senior creditors sometimes influence debtors to undervalue assets in order to enhance their recovery, often to the detriment of unsecured creditors).

⁹⁴ See Casey, *supra* note 93; *In re Chrysler LLC*, 576 F.3d 108, 114 (2d Cir. 2009) (noting that when pushed by a bullying creditor, “the natural tendency of a debtor in distress . . . is to pacify [that creditor] with whom the debtor would expect to do business” (internal quotation marks omitted) (quoting S. REP. NO. 95-989, at 10 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5796)); see also Ayotte & Morrison, *supra* note 87, at 514–15; David A. Skeel Jr., *Creditors’ Ball: The “New” New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 919 (2003); Elizabeth Warren & Jay L. Westbrook, *Secured Party in Possession*, 22 AM. BANKR. INST. J. 12, 12 (2003); Baird & Rasmussen, *Bankruptcy*, *supra* note 22, at 684–85.

⁹⁵ See LoPucki & Doherty, *supra* note 22, at 13 (explaining that many bankruptcy judges put so much faith in the auction process that they will not consider data that indicates that the sale price is woefully inadequate); see also LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* 73 (2005) (critiquing judges who assumed that agreements of parties reflect the market at work); Transcript of Applications for Employment; Cash Collateral Motion, and the Bid Procedures Motion; Request to Be Added to the Committee at 40, *In re Remington Outdoor Co.*, No. 20-81688 (Bankr. N.D. Ala. Aug. 18, 2020).

⁹⁶ LoPucki & Doherty, *supra* note 22, at 9.

Bankruptcy auctions are plagued by deficiencies. Revenue maximization is elusive, creating a diminished-yield universe. Even within this universe, outliers exist.

3. *Volatile Assets*

Auctions represent market assessments, but bankruptcy sales are infected with myriad deficiencies that can distort the process. Asset sales involving volatile assets are particularly troubling because of the possibility of extremely diminished yields. The term “volatile assets” describes assets subject to wild fluctuations because of exogenous market conditions—including economic shocks stemming from the Great Recession or the COVID-19 pandemic—that invariably affect a number of entities in an industry or multiple related industries.⁹⁷ Economic shocks could distort an auction in varied ways, including creating entry deterrence due to illiquidity in capital markets.

The fire sales in the Lehman Brothers and Chrysler bankruptcy cases occurred during the Great Recession and are just two examples of an exogenous market factor creating an auction with only one bidder⁹⁸ and paltry proceeds.⁹⁹ The General Motors asset sale occurred during the same period and attracted no bidders; the company was ostensibly sold to itself with funding from the U.S. government.¹⁰⁰

Sales involving volatile assets have heightened risks of depressed yields, especially in times when there are market corrections and certain industries are destabilized. In these settings, sellers have brought wares to an empty marketplace. Companies that continue on with an asset sale believing

⁹⁷ See Neyland & St. John, *supra* note 40, at 29.

⁹⁸ See David Teather, Andrew Clark & Jill Treanor, *Barclays Agrees \$1.75bn Deal for Core Lehman Brothers Business*, GUARDIAN (Sept. 16, 2008, 9:50 PM), <https://www.theguardian.com/business/2008/sep/17/barclay.lehmanbrothers1> [<https://perma.cc/7FGE-PQHV>]; Michael J. de la Merced & Micheline Maynard, *Fiat Deal with Chrysler Seals Swift 42-Day Overhaul*, N.Y. TIMES (June 10, 2009), <https://www.nytimes.com/2009/06/11/business/global/11chrysler.html> [<https://perma.cc/GC6Z-5JJ4>].

⁹⁹ The Lehman Brothers fire sale caused the company “to lose at least \$50 billion in portfolio value.” Mark J. Roe & Stephen D. Adams, *Restructuring Failed Financial Firms in Bankruptcy: Selling Lehman’s Derivatives Portfolio*, 32 YALE J. REGUL. 363, 386–88 (2015) (explaining why Lehman’s fire sale caused it to lose so much value); see also Edward R. Morrison, *Is the Bankruptcy Code an Adequate Mechanism for Resolving the Distress of Systemically Important Institutions?* 82 TEMP. L. REV. 449, 451–53 (2009) (discussing how the Bankruptcy Code is incapable of preventing major losses when major market players like Lehman Brothers become insolvent); Emily Chasan, *Lehman Says Barclays Got \$13 Billion Windfall in Sale*, REUTERS (Mar. 18, 2010, 5:03 PM), <https://www.reuters.com/article/us-lehman-barclays/lehman-says-barclays-got-13-billion-windfall-in-sale-idUSTRE62H5K920100318> [<https://perma.cc/PK3X-27J9>].

¹⁰⁰ See Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 537–38 (2009).

it to be the most viable means of preserving value invariably encounter terrible results.¹⁰¹

In the following Part, I argue that another unique class of assets exists alongside volatile assets. The assets in this class belong to debtors I refer to as “scarlet-lettered companies.” These companies own assets tainted by endogenous factors and face profound threats to revenue maximization that exist independent of customary market variables. This depressed-yield subset presents a heightened risk of staggering inefficiency. And these new cases are particularly troubling because diminished yields affect atypical creditors. I argue that asset sales involving scarlet-lettered companies would create massive speed discounts that are borne not by sophisticated creditors who enjoy various safety nets, but by mass tort victims—a group ill-equipped to bear this burden and one that lacks the ability to hedge these risks *ex ante*.

II. SCARLET-LETTERED COMPANIES AND RESIDUAL STAIN THEORY

Part I detailed the popularity of bankruptcy asset sales as a vehicle to compensate creditors. But these auctions are infected with myriad deficiencies that can distort the process and suppress proceeds. In this Part, I argue that there is a unique alternative for some mass tort defendants.

Auctions are intended to efficiently allocate assets among a group of bidders.¹⁰² Therefore, auction design and use must start by understanding participant demands. A seller’s comprehensive disclosure of ownership risks will increase the likelihood of maximized revenue in every auction type.¹⁰³ Unfortunately, a seller may be unable to properly assess the future risk associated with ownership of certain assets. And for a unique subset of entities—which I refer to as scarlet-lettered companies—this uncertainty can fuel pricing chaos.

Bankruptcy allows us to undertake an unprecedented analysis of scarlet-lettered companies through an auction-theory lens. We are at the forefront of an emerging trend in aggregate litigation. There are only a few cases so far—most notably Purdue Pharma and the bankruptcy of Johnson & Johnson’s

¹⁰¹ See LoPucki & Doherty, *supra* note 22, apps. A-1, A-2 (listing numerous examples, including Network Plus Corporation’s going-concern sale that yielded approximately 4% of book value).

¹⁰² MILGROM, *supra* note 31, at 6.

¹⁰³ See Rotem & Dekel, *supra* note 36, at 370–71 (citing Milgrom & Weber, *supra* note 33, at 1096) (explaining that a bidder, if unable to calculate the cost associated with risk of ownership, is likely to reduce her valuation of the asset by an amount at least equal to the expected loss arising from such risk; for this reason, disclosure of risks should not diminish auction proceeds, all else being equal).

talc subsidiary¹⁰⁴—but more await, including pharmacies in the drug supply chain that helped fuel the opioid crisis,¹⁰⁵ cell phone manufacturers that may obscure the risks of extended use of wireless products,¹⁰⁶ and food producers

¹⁰⁴ In October 2021, Johnson & Johnson executed a “divisive merger”—an extremely obscure maneuver that allowed for the isolation of all liability related to its talcum-powder business in a new limited-liability company called LTL Management LLC, while a host of valuable assets were transferred to another subsidiary. David Warfield, *Johnson & Johnson: The Texas Two-Step and Talc-Related Liabilities*, JDSUPRA (Nov. 3, 2021), <https://www.jdsupra.com/legalnews/johnson-johnson-the-texas-two-step-and-9551060/> [<https://perma.cc/46DN-YTG3>]. A number of valuable assets were transferred to another subsidiary. On October 14, 2021, LTL Management filed for bankruptcy while the other parts of the Johnson & Johnson empire stayed out of the process. *Id.*; see Rick Archer, *Johnson & Johnson Puts Talc Spinoff into Ch. 11*, LAW360 (Oct. 14, 2021, 6:29 PM), <https://www.law360.com/articles/1431315/johnson-johnson-puts-talc-spinoff-into-ch-11> [<https://perma.cc/ZRE2-G2N3>]; see also Jonathan Randles, Becky Yerak & Andrew Scurria, *How Bankruptcy Could Help Johnson & Johnson Corral Vast Talc Litigation*, WALL ST. J. (Nov. 12, 2021), <https://www.wsj.com/articles/how-bankruptcy-could-help-johnson-johnson-corrals-vast-talc-litigation-11626773400> [<https://perma.cc/DTK5-N6T3>] (explaining that “[d]ividing assets from liabilities is possible under a Texas corporate law through what are known as divisive mergers or divisional mergers.”). The bankruptcy case is currently pending before the U.S. Bankruptcy Court for the District of New Jersey. See Vince Sullivan, *J&J Talc Liability Unit’s Ch. 11 Transferred to NJ*, LAW360 (Nov. 10, 2021, 3:09 PM), <https://www.law360.com/bankruptcy/articles/1439777/j-j-talc-liability-unit-s-ch-11-transferred-to-nj> [<https://perma.cc/3TEQ-SKD5>]. Divisive mergers can be attacked as fraudulent transfers. If the bankruptcy court determines that Johnson & Johnson’s elaborate maneuver was a fraudulent transfer, the valuable assets that were separated from talc liabilities may be clawed back into the bankruptcy estate. Warfield, *supra*. In the case that the valuable assets are brought back into the bankruptcy estate, the public benefit proposal could help guide the disposition of these assets. Indeed, Johnson & Johnson’s talcum powder business “is still extremely profitable and does not face extensive legal challenges overseas that it does domestically.” Samir D. Parikh, *Mass Exploitation*, 170 U. PA. L. REV. ONLINE 53, 72 (2022); Jasper Jolly, *Johnson & Johnson Faces Push to Force Global Ban on Talc Baby Powder Sales*, GUARDIAN (Feb. 6, 2022, 8:50 AM), <https://www.theguardian.com/business/2022/feb/06/johnson-johnson-faces-push-to-force-global-ban-on-talc-baby-powder-sales> [<https://perma.cc/7C2H-R4NV>].

¹⁰⁵ See Ian Lopez, *Opioid Verdict Puts Health Systems Next in Line for Lawsuits*, BLOOMBERG L. (Dec. 15, 2021), <https://news.bloomberglaw.com/health-law-and-business/opioid-verdict-puts-health-systems-next-in-line-for-lawsuits> [<https://perma.cc/37WE-WLQF>] (explaining how Walmart Inc., CVS Health Corp., Walgreens, and others in the drug supply chain are now facing blame for fueling the opioid crisis).

¹⁰⁶ Some studies have established an increased risk—albeit nominal—of cancerous brain tumors in individuals who engaged in consistent cell phone use in proximity to their skull. The risk fluctuated with the number of years of use and increased after ten years of usage. See Seung-Kwon Myung et al., *Mobile Phone Use and Risk of Tumors: A Meta-Analysis*, 27 J. CLINICAL ONCOLOGY 5565, 5571 (2009); L. Lloyd Morgan, Anthony B. Miller, Annie Sasco & Devra Lee Davis, *Mobile Phone Radiation Causes Brain Tumors and Should Be Classified as a Probable Human Carcinogen*, 46 INT’L J. ONCOLOGY 1865, 1869 (2015) (finding that mobile phones can cause cancer, and that the risk of cancer is higher in people who began using cell phones as children). The latency period was believed to be no less than ten years. *Id.* Of course, the idea that cell phone use could present a material health risk to the general public is anathema. But this was also true with asbestos at the turn of the twentieth century. See generally P.W.J. Bartrip, *History of Asbestos Related Disease*, 80 POSTGRAD MED. J. 72 (2004) (outlining the importance of asbestos to industry in the early twentieth century and the slow realization of the dangers of asbestos). The health consequences would eclipse those posed by any other personal-injury mass tort because cell

that recklessly distributed tainted infant formula.¹⁰⁷ For now, much of the formulation is theoretical, requiring an extrapolation from what we already know.

A. Understanding Scarlet-Lettered Companies

The United States is experiencing a renewed emphasis on accountability. Individual and corporate malfeasance are being addressed differently than in previous generations. I believe this new environment will accelerate the rise of scarlet-lettered companies. A scarlet-lettered company is one responsible for gross criminality and corporate misconduct that produces harm on a large scale and, once revealed, earns the company searing public scorn and diminished asset values.

Scarlet-lettered companies can highlight historical failures. Almost all of the ones we have seen so far involve criminality or significant malfeasance committed years or decades ago that was overlooked at the time. Previous generations' inertia and apathy are often the reasons why such gross transgressions were allowed to continue unabated. Holding scarlet-lettered companies responsible today is the manifestation of a societal shift.

Social science and business literature have explored this shift and attributed it to a generational value swing, coupled with social media's ability to connect and mobilize historically silenced groups.¹⁰⁸ Researchers

phone manufacturers would face potential liability from the cell phones they sold as well as other peripherals, including wireless headphones. See SWISS RE INST., SWISS RE SONAR: NEW EMERGING RISK INSIGHTS 29 (2019), https://www.swissre.com/dam/jcr:5916802c-cf6b-4c67-9d42-39cf80c4b00d/SONAR%20Publication%202019_WEB_quality.pdf [https://perma.cc/3EFH-R6D4] (noting that some studies find significant health concerns regarding electromagnetic radiation from cell phones and related wireless sources); Joel M. Moskowitz & Larry Junck, *Should Cellphones Have Warning Labels?*, MARKETWATCH (June 11, 2016), <https://www.marketwatch.com/story/should-cellphones-have-warning-labels-2016-06-11> [https://perma.cc/DS32-RPZM]; LLOYD'S, LLOYD'S EMERGING RISKS TEAM REPORT: ELECTRO-MAGNETIC FIELDS FROM MOBILE PHONES: RECENT DEVELOPMENTS 14 (2010), <https://assets.lloyds.com/assets/pdf-emf-final-november-2010/1/pdf-emf-final-november-2010.pdf> [https://perma.cc/8U57-DXUQ] (warning that scientific and legal developments could change the insurance climate and comparing the potential risk to what occurred with asbestos).

¹⁰⁷ See Susan Berfield & Anna Edney, *Inside the Infant Formula Disaster*, BLOOMBERG: BUSINESSWEEK (Aug. 29, 2022, 11:01 PM), <https://www.bloomberg.com/news/features/2022-08-25/baby-formula-shortage-a-deadly-bacteria-and-abbott-s-abt-missteps> [https://perma.cc/VD8E-7XTK].

¹⁰⁸ For example, Boy Scouts of America (BSA) held records detailing unaddressed abuse by volunteers from as early as 1919. Arthur W. Humphries, *Inside the 'Perversion Files,'* L.A. TIMES (Sept. 14, 2012), <https://documents.latimes.com/boy-scouts-paper-trail-of-abuse-documents/> [https://perma.cc/75UR-RS7Z]. BSA took no meaningful action against abusers through multiple generations, even though allegations were well-known. *Over 100 Years of Hidden Abuse, ABUSED IN SCOUTING*, <https://abusedinscouting.com/history-of-abuse/> [https://perma.cc/E6PB-X37F]. Throughout the twentieth century, when faced with a survivor suit based on sexual abuse, BSA invoked statutes of

have been attempting to conceptualize this phenomenon and its larger impacts. The findings reveal that younger generations have a stronger social conscience¹⁰⁹ and lack faith in the ability of traditional institutions to prevent or police criminal behavior;¹¹⁰ many have realized that monitors have brazenly obfuscated their oversight lapses.¹¹¹ This enlightenment has fueled movements that rely on online social networks to galvanize supporters and demand corrective measures. Furthermore, the willingness of victims to share their stories publicly has forced wrongdoers to confront critical masses of individuals exhibiting levels of harm that cannot be dismissed. The resulting phenomenon has already subjected numerous individuals and

limitation to avoid liability. *New Lawsuit Could Allow Boy Scouts to File Sex Abuse Claims Even if the Statute of Limitations Has Expired in Their States*, CBS NEWS (Jan. 6, 2020), <https://www.cbsnews.com/news/bsa-lawsuit-boy-scouts-of-america-faces-new-lawsuit-that-could-allow-more-scouts-to-file-claims-today-2020-01-06/> [<https://perma.cc/LUZ6-K88X>]. But in the 2000s, public outcry pushed the moment to crisis. *Over 100 Years of Hidden Abuse*, *supra*. State legislatures passed laws extending the statutes of limitations in these cases to allow suits to proceed. *Id.* Survivor suits ultimately forced BSA to release its records, which documented the abuse in excruciating detail. *Id.* This action forced BSA to file for bankruptcy. *Id.*

The same dynamic emerged with USA Gymnastics and Larry Nassar. Sexual and physical abuse had been a staple of organized women's gymnastics for decades, without comment. Anna North, *Gymnastics Still Hasn't Fully Reckoned with Its Abuse Problem*, VOX (July 24, 2021, 9:00 AM), <https://www.vox.com/22585637/gymnastics-tokyo-olympics-2021-abuse-larry-nassar> [<https://perma.cc/Q4GG-WJH4>] (stating that USA Gymnastics has a history of "mishandling or dismissing reports of abuse" and that "many gymnasts have also said that the culture of gymnastics perpetuate[s] physical and emotional abuse"). But something shifted in 2016: female athletes organized and demanded accountability, ultimately forcing that organization to disclose secret dossiers on over fifty coaches and doctors who had been accused of sexual abuse but had never been reported. Marisa Kwiatkowski, *Larry Nassar's Abuse of Gymnasts, Including Simone Biles Went Back Decades. Why It Still Matters in Tokyo.*, USA TODAY (July 27, 2021), <https://www.usatoday.com/story/sports/olympics/2021/07/27/usa-gymnastics-larry-nassar-abuse-scandal-looms-over-tokyo-olympics/5375279001/> [<https://perma.cc/US42-UCFY>].

¹⁰⁹ See DELOITTE, *supra* note 19, at 28–32.

¹¹⁰ See, e.g., Elena Chatzopoulou & Adrian de Kiewiet, *Millennials' Evaluation of Corporate Social Responsibility: The Wants and Needs of the Largest and Most Ethical Generation*, 20 J. CONSUMER BEHAV. 521, 530–31 (2021) (discussing findings of "broad cynicism" of corporate ethicality in Millennials); Aryn Baker, *Global Youth in Revolt*, TIME, Feb. 3, 2020, at 48, 49 (describing various global youth-led movements that share "a desire to tear down and rebuild structures built by past generations"); Linda S. Greene et al., *Talking About Black Lives Matter and #MeToo*, 34 WIS. J. L. GENDER & SOC'Y 109, 119–21 (2019) (proposing that a key commonality between the Black Lives Matter and #MeToo movements is "a rejection of institutions and traditional hierarchies"); Melissa Lane, *The Moral Dimension of Corporate Accountability*, in GLOBAL RESPONSIBILITIES: WHO MUST DELIVER ON HUMAN RIGHTS? 229, 229–31 (Andrew Kuper ed., 2005) (discussing whether corporations can and should take moral responsibility in response to increasing calls for greater corporate accountability from activists and academics); see also Marshall Ganz, *Leading Change: Leadership, Organization, and Social Movements*, in HANDBOOK OF LEADERSHIP THEORY AND PRACTICE: A HARVARD BUSINESS SCHOOL CENTENNIAL COLLOQUIUM 527, 530 (2010) (noting that the function of social movements is to change the rules and that "social movement leadership is often drawn from among the young").

¹¹¹ See DELOITTE, *supra* note 19, at 28–32; see also Greene et al., *supra* note 110, at 111–12, 119–21 (discussing how social media helped give traction to the BLM and #MeToo movements).

entities to public scrutiny in unprecedented ways. The ensnared include individuals like Bill Cosby, Harvey Weinstein, and Jeffrey Epstein;¹¹² corporate behemoths like 3M, Johnson & Johnson, and Purdue Pharma; and nonprofit organizations like USA Gymnastics, Boy Scouts of America, and countless archdioceses.¹¹³

Criminal prosecution offers closure for some victims and the promise of precluding future criminality, but victims invariably require financial compensation in order to reassemble fractured pieces. And the most daunting resolution complexities exist in this civil-recovery sphere.

Scarlet-lettered companies are a new species in the mass tort universe, and they will require unique avenues to resolution. Current examples have sought settlement through federal bankruptcy, eschewing traditional litigation forums, including multidistrict litigation.¹¹⁴ I argue that this maneuver will persist for these defendants because scarlet-lettered companies are not contesting liability.¹¹⁵ Bankruptcy offers comprehensive claim aggregation, accelerated resolution, and valuable optionality, all of which are particularly attractive to mass tort defendants.¹¹⁶ But the bankruptcy process is characterized by forum shopping¹¹⁷ and statutory loopholes¹¹⁸ that allow mass-restructuring debtors to impose a new bargain on victims. These dynamics can create inequitable outcomes and heighten the risk that victims' trusts will be prematurely insolvent. Early trust failure invariably means that victims' claims will be unsatisfied.

¹¹² See Amanda Kerri, *Why Did It Take So Long to Take Down Epstein, Cosby, and Spacey?*, ADVOCATE (July 12, 2019, 1:40 PM), <https://www.advocate.com/commentary/2019/7/12/why-did-it-take-so-long-to-take-down-epstein-cosby-and-spacey> [<https://perma.cc/7GEF-HWJA>].

¹¹³ I acknowledge that plaintiffs' attorneys also play a role in advancing movements. See, e.g., Sara Randazzo & Jacob Bunge, *Inside the Mass-Tort Machine that Powers Thousands of Roundup Lawsuits*, WALL ST. J. (Nov. 25, 2019), <https://www.wsj.com/articles/inside-the-mass-tort-machine-that-powers-thousands-of-roundup-lawsuits-11574700480> [<https://perma.cc/62KW-V2LQ>] (describing how there has been a surge in mass tort litigation because of "a little-known sophisticated legal ecosystem that includes marketing firms that find potential clients, financiers who bankroll law firms, doctors who review medical records, scientists who analyze medical literature and the lawyers who bring the cases to court").

¹¹⁴ See Parikh, *supra* note 18, at 28; see generally Parikh, *supra* note 104, at 53 (arguing that "mass tort defendants" like "Johnson & Johnson, Purdue Pharma, USA Gymnastics, and Boy Scouts of America" use bankruptcy strategically for settlement).

¹¹⁵ Parikh, *supra* note 18, at 20 (explaining that the scale of the harm and the number of claims is great and necessitates settlement regardless of the merits of each individual claim).

¹¹⁶ *Id.* (explaining the attractiveness of the bankruptcy process).

¹¹⁷ See, e.g., LoPucki & Doherty, *supra* note 22, at 40–41 (describing how court competition has incentivized forum shopping); see also Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. (forthcoming 2022) (manuscript at 9–10), <https://www.lopucki.com/pdf/LoPucki%20Chapter%2011's%20Descent%20into%20Lawlessness.pdf> [<https://perma.cc/6TXX-MM2E>]; Samir D. Parikh, *Modern Forum Shopping in Bankruptcy*, 46 CONN. L. REV. 159, 173–81 (2013).

¹¹⁸ See Parikh, *supra* note 18, at 6; Parikh, *supra* note 104, at 60–64.

The same issues that plague companies selling volatile assets affect scarlet-lettered companies, but the potential harm is amplified. Resolution complexity is especially pernicious because the scale is vast—requiring significant resources to address victims’ claims—but public scorn creates aggravated value diminution. The very assets necessary to compensate victims are inexorably tainted by the exposure that brought the scandal forward in the first place. Also, asset value is further suppressed by the fear that successor liability will plague any potential buyer in the event that victims are not properly compensated through the bankruptcy process.¹¹⁹ Options for preserving value are limited.

The overlooked and misunderstood process unfolds in the stages outlined below.

1. *Public Scorn and Social Norms*

Factors that temporarily suppress asset value are prevalent in most bankruptcy cases. These factors can involve operational deficiencies, spikes in debt payments, overall market instability, industry-specific distress, or barriers to capital.¹²⁰ Naturally, each of these factors can lead to a company’s demise. With scarlet-lettered companies, the suppression can be extremely prolonged.

Scarlet-lettered companies involve tainted assets, which I argue are similar to volatile assets in that both can wildly fluctuate in value. However, tainted assets are distinct because the fluctuations are not based on exogenous market conditions affecting various entities and industries; rather, endogenous factors are at the root. Public outrage over criminal and tortious conduct committed by an entity’s agents has compromised an otherwise-viable business and introduced bankruptcy in an attempt to resolve creditor claims.

Public scorn is a defining characteristic of scarlet-lettered companies. Purdue is a powerful example. Purdue was not solely responsible for the opioid crisis, but it was certainly the alpha—developing the fountainhead drug and depraved distribution strategies that other companies would

¹¹⁹ The General Motors bankruptcy case is the primary example. In that case, individuals harmed prior to bankruptcy by ignition-switch defects hidden by GM engineers were allowed to assert successor liability claims against New GM, the winning bidder at the auction of the estate’s key assets. *See Elliott v. General Motors, LLC (In re Motors Liquidation Co.)*, 829 F.3d 135, 166 (2d Cir. 2016); Vincent S.J. Buccola & Joshua C. Macey, *Claim Durability and Bankruptcy’s Tort Problem*, 38 *YALE J. ON REGUL.* 766, 783–94 (2021) (advocating for bankruptcy courts to impose successor liability in cases involving tort claims); *see also* Brad Warner, *Reconciling Bankruptcy Law and Corporate Law Principles: Imposing Successor Liability on GM and Similar “Sleight-of-Hand” 363 Sales*, 32 *EMORY BANKR. DEVS. J.* 537, 545–48 (2016).

¹²⁰ *See* Kenneth Ayotte & Edward R. Morrison, *Valuation Disputes in Corporate Bankruptcy*, 166 *U. PA. L. REV.* 1819, 1827 (2018).

mimic.¹²¹ But Purdue's depravity does not change the fact that the company had an extremely profitable business. The company's core business could have been auctioned with proceeds used to compensate victims. The fear, however, was that the sale would have been disastrous,¹²² and victims would have been forced to accept heavily discounted recoveries. I believe that this is the risk for future scarlet-lettered companies as well. The overriding concern is that bidder discounting will be severe because these cases create a unique market condition.

As noted above, bankruptcy auctions can be extremely inefficient. This risk is heightened with scarlet-lettered companies because of the likelihood that public scorn will create social-norm effects. Economic literature began exploring social norms in the 1980s. Professor George Akerlof argued that various conditions exist in which an individual may avoid otherwise advantageous conduct if she faces a material risk of being sanctioned for flouting a particular custom or norm.¹²³ Social norms are impactful because they can override the profit motive in some cases and completely shape economic behavior and outcomes in others.¹²⁴ For example, imagine local landlords in a small town subject to a social norm that urges them to avoid renting apartments to wealthy, out-of-state tourists during summer months. Landlords with discriminatory practices arising from these norms receive far less rental income but may accept this outcome because of community pressure. In areas of strong community engagement, the norm will actually override the profit motive.

Social norms can also emanate from a different source. A group of high-school students may agree to no longer work at a restaurant because the owner is an ardent supporter of a particularly vile political figure. This choice may cause significant financial loss for many of the students. The restaurant owner may also suffer if this sentiment affects key customers. Indeed,

¹²¹ See Parikh, *supra* note 18, at 3.

¹²² See Disclosure Statement for Third Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors apps. A & B, *In re Purdue Pharma, L.P.*, 635 B.R. 26 (Bankr. S.D.N.Y. 2021) [hereinafter Purdue Disclosure Statement].

¹²³ See George A. Akerlof, *A Theory of Social Custom, of Which Unemployment May Be One Consequence*, 94 Q.J. ECON. 749, 749–50 (1980); see also Elinor Ostrom, *Collective Action and the Evolution of Social Norms*, 14 J. ECON. PERSPS. 137, 137–38 (2000); Jon Elster, *Social Norms and Economic Theory*, 3 J. ECON. PERSPS. 99 (1989) (summarizing key concepts in social norm scholarship); David Romer, *The Theory of Social Custom: A Modification and Some Extensions*, 99 Q.J. ECON. 717 (1984) (expanding the theory).

¹²⁴ See Harrison Hong & Marcin Kacperczyk, *The Price of Sin: The Effects of Social Norms on Markets*, 93 J. FIN. ECON. 15, 15–16 (2009).

businesses customarily experience social-norm effects through customer loss and diminished revenue.¹²⁵

“Sin companies” offer an alternative example. A sin company is a business that sells goods or services that historically have been considered unethical or morally corrupting, including adult entertainment, gambling, and tobacco. Economic literature argues that reputational risk exists in this context—the idea that social norms can negatively affect the market valuation of publicly traded sin companies because customers and investors may prefer to limit engagement with such companies.¹²⁶ This aversion can affect potential investors and purchasers of goods and services. Many investors are disinclined to invest in these companies, which increases the cost of capital.¹²⁷ Customers may be interested in purchasing the goods or services being offered but feel pressure to limit their frequency. Consequently, when valuing sin companies, investment bankers customarily include an aversion discount.¹²⁸

Asset valuation in every auction is subject to ex post risk due to variables that could affect value after the auction is concluded. But auction theory often assumes that the legal and social risks inherent in purchasing assets at auction are assessable prior to bidding. And while this is true for most auctions, others involve assets for which there is no informational sweet spot.¹²⁹ In these situations, even the seller does not have the means to properly assess the risks of ownership. Costs arising from these information gaps are

¹²⁵ N. Craig Smith & Markus Scholz, *Identifying Social Norms Makes for Better Business*, KNOWLEDGE (June 12, 2017), <https://knowledge.insead.edu/responsibility/identifying-social-norms-makes-for-better-business-6356> [<https://perma.cc/XE7T-44CG>] (“By identifying existing norms, or indeed becoming a norm maker, firms can maintain their legitimacy and manage business profitably while contributing to societal progress.”).

¹²⁶ See Hong & Kacperczyk, *supra* note 124, at 15–16.

¹²⁷ See *id.* I acknowledge that this aversion may not materially affect a company’s performance because (1) customers enjoy the good or service being sold and are unaffected by social norms and (2) some investors are dissuaded but others—especially those guided solely by profit—are willing to invest. I make this analogy because, in a scarlet-lettered bankruptcy, key victim groups must assess whether some extreme discounting exists and, if so, whether the public benefit proposal effectively addresses value suppression.

¹²⁸ An analog to sin-company aversion involves “dirty” companies that engage in activities that could be characterized as fundamentally destructive to the environment. Examples include oil and gas companies like Shell Oil. See generally Cara Lombardo & Sarah McFarlane, *Third Point Has Big Shell Stake, Urges Energy Giant to Break Up*, WALL ST. J. (Oct. 27, 2021), <https://www.wsj.com/articles/third-point-has-big-shell-stake-urges-energy-giant-to-break-up-11635349151> [<https://perma.cc/KF9N-NKH5>].

¹²⁹ See Douglas G. Baird & Edward R. Morrison, *Bankruptcy Decision Making*, 17 J.L. ECON. & ORG. 356 (2001) (hypothesizing an informational sweet spot in which all parties and the bankruptcy court have gathered sufficient information about the debtor to make an informed decision about asset value, and the costs of waiting for additional information will exceed the benefits of that information).

unknown and can be determined only at some point well after the auction concludes.

Expanding on existing literature, I argue that social norms have particularly severe effects on scarlet-lettered bankruptcies. Companies such as Purdue face a stain on their brands and businesses that distorts investor and customer engagement.¹³⁰ Unfortunately, it is hard to assess the residual impact of a social-norm stain on future sales and essential business relationships for a company subject to public scorn. When scarlet-lettered companies arrive in bankruptcy, a Section 363 sale is often the most viable course. But uncertainty regarding residual stains will distort scarlet-lettered auctions.

Auction withdrawal—the idea that bidders will refuse to participate in auctions due to unascertainable risks—is one consequence of residual stains. Bidders fear that the scorn that affects the scarlet-lettered company will be transferred to any buyer of the company. Even bidders who overcome this initial hurdle¹³¹ and enter a scarlet-lettered auction are still plagued by cautionary bidding. Professors Peter Ésö and Lucy White have developed the theory of cautionary bidding, which supports a simple premise: when valuations become noisy from ex post risk that is difficult to assess, bidders reduce their bids by more than the corresponding increase in the risk premium.¹³² This idea may be deemphasized in auctions involving spectrum licenses, marketable securities, municipal bonds, offshore oil leases, or timber rights, where legal liabilities and public scorn are rarely apparent. But value distortion caused by lingering risk is an important variable in auctions involving a company that has inflicted widespread harm on the general public. The potential curse is that the winner of the auction is likely to be the party who has greatly underestimated the impact of the residual stain and thereby overestimated the asset's value. I believe that the uncertainty of legal and business costs associated with the auctioned assets will cause bidders to reduce their bids to a degree that materially exceeds any actual costs the winning bidder will bear. Outside of bankruptcy, this type of discounting is

¹³⁰ See generally Glazek, *supra* note 3. In Purdue's case, the stain extended to the Sackler family as well. *Id.*

¹³¹ Auction models frequently adopt a private-values assumption, meaning that each bidder can make an accurate internal assessment of an auctioned asset's value but cannot make an accurate external assessment; in other words, a bidder can accurately assess what value an asset being auctioned will have to that particular bidder, but the bidder does not know the value of that asset to other bidders. See, e.g., Milgrom & Weber, *supra* note 33, at 1090. However, there are many cases in which a bidder lacks information necessary to make a meaningful internal assessment of value, which can create various consequences.

¹³² In this context, the "risk premium" can be summarized as the additional cost associated with owning an asset affected by unknown or unforeseen factors that could depress value. See generally Péter Ésö & Lucy White, *Precautionary Bidding in Auctions*, 72 *ECONOMETRICA* 77, 78 (2004).

terrible for the seller. Inside of bankruptcy, this type of discounting is terrible for mass tort victims who are dependent on auction proceeds.

Residual stains and the rush to sell assets will produce staggeringly diminished yields in scarlet-lettered auctions.¹³³ As noted above, a significant portion of bankruptcy-auction literature overlooks cautionary bidding and instead touts the idea of a speed premium. This perspective has helped fuel the popularity of asset sales.

Scarlet-lettered auctions do not enjoy a speed premium. Speed kills value in these cases. Instead, we have a speed discount, and mass tort victims must bear it.

2. *The Consequences of Cautionary Bidding and the Speed Discount*

Residual stain theory allows scholars to address one of the key questions in the brave new world of mass restructurings: how great is the discount attributed to bids for tainted assets? We currently lack data to formulate an answer, but I suspect that this discounting will cause the bids at auction to fall well below any reasonable seller's reservation price. Outside of bankruptcy, the auction would not go forward, but as explained above, reserve pricing is irrelevant in many of these bankruptcies. These dynamics set up a disastrous scenario.

I theorize that the risks of auction withdrawal and cautionary bidding will be understated in scarlet-lettered bankruptcies. Path dependence will lead debtors to pursue an asset sale merely because a traditional reorganization is completely infeasible. There is no reserve pricing in these auctions. The bankruptcy court will approve bidding procedures that blindly adopt an English auction and otherwise chill bidding. The unique dynamics that infect scarlet-lettered auctions cause widespread auction withdrawal, and the winning bid—assuming there is one—is well below fair market value. The court will approve the results on the false premise that the assets were properly exposed to the market and the resulting price must be recognized as fair market value; no consideration will be given to whether a delayed sale would have produced a significantly improved price. Diminished funds flow into the victims' settlement trust, the linchpin of the entire bankruptcy case.

Embedded in this scenario is the heightened risk that the settlement trust will be prematurely insolvent and victims with ostensibly identical claims will receive vastly different recoveries, even though the only material difference is the timing of their manifestations of harm. The most overlooked facet of this process is that there is no backstop if the trust becomes insolvent

¹³³ See Purdue UCC Plan Support Letter, *supra* note 23, at 32.

prematurely.¹³⁴ The debtor is liquidated and no longer exists. Insurance companies, the parent entity, and affiliated entities all receive releases through the plan. If the debtor's assets were auctioned, the acquirer does not assume any pre-petition liability. The Future Claimants Representative (FCR),¹³⁵ who may have agreed to a poor settlement, has complete immunity. Claimants who did not receive actual notice of the case cannot predictably rely on procedural due process arguments. Constructive notice and the FCR's involvement most likely satisfy due process because the procedures are reasonable under the circumstances.¹³⁶ Bankruptcy's dirty little secret is that no one stands behind a failed trust.¹³⁷

A doomed auction, however, is not the only option.

3. *Value Rebound*

The bankruptcy process attracts a cavalcade of distinct entities but then ostensibly offers only two resolution options for viable businesses. These options are impactful in most cases, but scarlet-lettered bankruptcies demand

¹³⁴ The victims' settlement trust in the Johns-Manville bankruptcy is the most prominent example. By the early 1990s, trust administrators realized that the trust had insufficient assets to pay prospective claimants the full value of their claims. Consequently, the trust was allowed to begin paying claimants a pro rata share of the liquidated value of their claims based on a percentage set by the trust. The percentage was initially set at 10% in 1995 but is currently only 5.1%. See Claims Resol. Mgmt. Corp., 2002 Trust Distribution Process: May 2021 Revision 17 (unpublished manuscript) (on file with author); telephone conversation by Javier Jose Daza Rossi with a representative of the Asbestos Claims Rsch. Facility at the Claims Resol. Mgmt. Corp. (May 31, 2022); see also *Stephenson v. Dow Chem. Co.*, 273 F.3d 249, 260–61 (2d Cir. 2001) (noting that the exhaustion of a class action settlement fund led to claimants challenging the settlement on due process grounds), *aff'd by an equally divided court in part, vacated in part*, 539 U.S. 111 (2003) (per curiam).

¹³⁵ The Future Claimants Representative is an individual appointed to represent the interests of future victims in mass restructurings. This individual arguably helps satisfy due process strictures, but the impartiality of the individual has been questioned:

The idea that the FCR would fail to be a zealous advocate may seem confusing at first but emerges with shocking clarity when one considers the capture risk involved in mass tort cases. A small pool of professionals manages the universe of mass tort bankruptcy cases, and the process is characterized by repeat players. FCRs receive significant fees and, once appointed, immediately hire as legal counsel the law firm at which they are a partner, thereby amplifying the benefit. Therefore, the promise of multiple engagements is a truly distortive incentive for these individuals. This promise can incentivize an FCR to discount her invisible clients' interests. FCRs seeking subsequent engagements face extreme pressures to avoid taking positions in one case that may alienate key parties who will be involved in future cases.

Parikh, *supra* note 18, at 38–39 (footnotes omitted). I have also argued that “a bankruptcy court should be authorized to remove an FCR after appointment if the court determines that the change is necessary to ensure adequate representation of claimants.” *Id.* at 44; see also Sergio Campos & Samir D. Parikh, *Due Process Alignment in Mass Restructurings*, 91 *FORDHAM L. REV.* (forthcoming 2022) (manuscript at 6), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4088836 [<https://perma.cc/DTK5-63D8>].

¹³⁶ See Campos & Parikh, *supra* note 135, at 17–23.

¹³⁷ See *supra* note 24.

a novel approach. What if we could defer the bankruptcy auction to capture a potential value rebound?

Residual stains may not be inveterate. In a new paper, Professors Jordan Neyland and Kathryn St. John argue that with highly volatile assets, the value added by a delay can in many cases far outweigh any incremental asset value decline.¹³⁸ Recall that the predominant argument to justify the speed premium is that the assets being sold face consistent value deterioration in bankruptcy. This argument overlooks the potential for a meaningful rebound in certain cases. Recent studies indicate that a value rebound is a significant possibility in many accelerated auctions.¹³⁹ As explained by Professors Neyland and St. John, “[e]ven at a 10% annual rate of value decline, the effect on shareholders’ and creditors’ value from the extension of time significantly exceeds the effects from asset value decline.”¹⁴⁰ They further argue that if asset values are volatile, there is greater potential for shareholder gains by waiting.¹⁴¹

In scarlet-lettered bankruptcies—for which asset values are uniquely volatile—the speed discount is exaggerated, and victims can lose even more value than in typical cases. Naturally, in many traditional bankruptcy cases, value deterioration is dramatic and uninterrupted. Even a multi-year delay would not improve yield. In these cases, the speed premium justifies an accelerated asset sale. But the situation is hardly as ubiquitous as debtors and secured creditors would have bankruptcy courts believe. More important, I argue that this will not be the typical scenario for scarlet-lettered companies.

As noted above, with court permission, an asset sale can occur outside the debtor’s ordinary course of business and without creditor consent—even though key creditors are often encouraging the auction. Courts need only determine that a valid business justification supports the sale.¹⁴² Courts consider numerous factors in making this assessment, including whether the assets at issue are depreciating in value, but courts never consider the possibility of a value rebound if the sale is delayed for some period of time.¹⁴³

¹³⁸ Neyland & St. John, *supra* note 40, at 6.

¹³⁹ *See id.* at 5–6; *see also* Franks et al., *supra* note 61 (pointing to value rebound due to buyers being more efficient users of the resources than the previous owners).

¹⁴⁰ Neyland & St. John, *supra* note 40, at 5.

¹⁴¹ *Id.* at 6.

¹⁴² *See id.* at 25.

¹⁴³ *See id.* at 5 (“In *Chrysler*, the court uses the ‘melting ice cube’ theory to justify a 363 sale, as the going concern value of the company was in steep decline. This focus on asset depreciation in the court’s opinion, arguably, dominates the decision to proceed with a 363 sale under the business justification standard.” (citing *In re Chrysler LLC*, 576 F.2d 108, 114 (2d Cir. 2009))).

Could a deferred auction—perhaps months or even years down the road—be the obvious solution for scarlet-lettered companies? This idea may sound too good to be true, and in fact it is. A deferred asset sale offers the potential of capturing the value rebound. This adjustment, however, is only part of the solution because a mere delay is not sufficient by itself to remove residual stains and rebuild customer and investor relationships. Furthermore, scarlet-lettered bankruptcies involve unique creditor groups, including current victims, future victims, state governments, and federal agencies. In order to avoid liquidation and secure the various prizes the process offers, debtors need support from these stakeholders.¹⁴⁴ In fact, bankruptcy’s collaborative ethos also includes the bankruptcy court, which must approve unique forms of relief and the ultimate resolution design. A mere delayed sale cannot address all these demands.

As explored below, the second key part of the resolution puzzle involves the entity that emerges from bankruptcy.

B. *Public Benefit Companies and Stakeholder Primacy*

For the last half-century, U.S. businesses have embraced shareholder primacy—the idea that a company’s sole purpose is to prioritize shareholder profits to the exclusion of customers, stakeholders, and communities.¹⁴⁵ Courts have reinforced this approach with threats of personal liability for directors who deviate from the course.¹⁴⁶ Nevertheless, the approach is still

¹⁴⁴ A debtor could try a customary asset sale, but without stakeholder consent, there will be extensive intercreditor battles regarding distribution of proceeds. The bankruptcy court will not approve the debtor’s resolution measures without a material level of creditor consent. Furthermore, a traditional Chapter 11 reorganization is similarly futile because a mere rebranding will not remove the residual stain, *see* Elizabeth A. Smith & Ruth E. Malone, *Altria Means Tobacco: Philip Morris’s Identity Crisis*, 93 AM. J. PUB. HEALTH 553, 554–55 (2003), and creditors are highly unlikely to support a restructuring with dim prospects of returning value.

¹⁴⁵ *See* Lucian A. Bebchuk, *The Myth of Shareholder Franchise*, 93 VA. L. REV. 675, 679–82 (2007); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988) (“The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”); *see also* Andrew Ross Sorkin, *How Shareholder Democracy Failed the People*, N.Y. TIMES (Aug. 21, 2019), <https://www.nytimes.com/2019/08/20/business/dealbook/business-roundtable-corporate-responsibility.html> [<https://perma.cc/4PM5-LY58>] (“For nearly a half-century, corporate America has prioritized, almost maniacally, profits for its shareholders. That single-minded devotion overran nearly every other constituent, pushing aside the interests of customers, employees and communities.”); Milton Friedman, *A Friedman Doctrine—the Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> [<https://perma.cc/W87N-AVUG>].

¹⁴⁶ Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 751 (2007).

controversial.¹⁴⁷ Professor Lynn Stout and others have argued that long-term corporate viability is premised on considering the triple bottom line: stakeholders, the environment, and the community. Their foundational premise is that relentlessly maximizing value for oneself—regardless of the cost to others—is anathema to a properly functioning society. Similarly, a corporate law model that compels directors through fiduciary duty obligations and the threat of personal liability to take only actions that maximize shareholder value—regardless of the cost to stakeholders and communities—is anathema to an optimal, long-term business framework. Professor Colin Mayer argues that shareholder primacy erodes long-term value maximization of the corporate entity.¹⁴⁸

An assessment of shareholder primacy is beyond this Article’s scope, and such an assessment is unnecessary to resolving scarlet-lettered bankruptcies. In 2013, just as a decades-old debate regarding shareholder primacy was reinvigorated, the Delaware legislature muted the vitriol by enacting a statute authorizing entities to organize as companies for the public benefit.¹⁴⁹ Companies interested in pursuing the triple bottom line—stakeholders, the environment, and community—now had an alternative from the most prominent corporate venue in the country. Under the new statute, directors at Delaware public benefit corporations are mandated to consider stakeholders alongside shareholders.¹⁵⁰ More specifically, directors must balance (1) shareholders’ pecuniary interests, (2) the best interests of all other groups who are materially affected by the corporation’s conduct, and (3) the specific public benefit or benefits identified in the certificate of incorporation.¹⁵¹ To be clear, a public benefit corporation is not a nonprofit. It is merely a traditional corporation that has a profit motive alongside community and environmental objectives. This entity’s design allows for

¹⁴⁷ See, e.g., COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD 31–45 (2018) (arguing that “an excessive focus on shareholder returns or stakeholder interests” is one reason “[w]e have lost trust in corporations”); LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 13–60 (2012); Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders*, 66 WASH. & LEE L. REV. 1635, 1639 (2009) (“[E]nhanced share price is at best a byproduct of activity that, as I will argue, has distorted the productive incentives of corporate management to the potential long-term harm of American industry.”); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 783–96 (2005) (“To at least some extent, shareholders value nonfinancial aspects of corporate activities Thus, maximizing shareholder welfare is not the same thing as maximizing shareholder profits.”).

¹⁴⁸ See MAYER, *supra* note 147, at 44.

¹⁴⁹ *Delaware Enacts Benefit Corporation Legislation*, FOLEY HOAG LLP (July 23, 2013), <https://foleyhoag.com/publications/alerts-and-updates/2013/july/delaware-enacts-benefit-corporation-legislation> [<https://perma.cc/YRB5-38EN>].

¹⁵⁰ See Leo E. Strine, Jr., *Making It Easier for Directors to “Do the Right Thing”?*, 4 HARV. BUS. L. REV. 235, 243 (2014).

¹⁵¹ DEL. CODE ANN. tit. 8, § 362(a) (2022).

accommodating the interests of various parties, as captured in the incorporating documents. Despite their recent vintage, Delaware public benefit corporations benefit from the fact that Delaware corporate law is widely accepted among institutional investors, corporate managers, and various intermediaries who raise capital.¹⁵²

The public benefit model offers a third option for scarlet-lettered companies in bankruptcy. An accelerated bankruptcy auction overlooks the possibility of a value rebound and creates a level of discounting that threatens to eviscerate the fundamental tenets of victim recovery. The idea of a traditional reorganization is attractive, but the vehicle necessary to animate that form needs approval from victims and the bankruptcy court. The reorganized entity must reestablish its reputation among customers and investors and still address the myriad issues that caused mass harm. A public benefit corporation can fulfill that directive and act as a bridge to a final sale of the business three to five years after the bankruptcy case—a time when a full value rebound has a greater chance of materializing.

The next Part explains the public benefit proposal's structure and key facets.

III. THE PUBLIC BENEFIT PROPOSAL

Part II highlighted the resolution deficiencies that scarlet-lettered companies will experience in bankruptcy, the results of which are prematurely insolvent trusts and unsatisfied victims' claims. A deferred auction can alleviate this quandary when coupled with a reorganized entity that has the ability to secure stakeholder buy-in and facilitate a value rebound. The public benefit proposal assembles these disparate pieces to formulate an innovative resolution option designed to equitably compensate mass tort victims.¹⁵³

One way to conceptualize the public benefit proposal is to analogize to a criminal forfeiture.¹⁵⁴ Imagine a small criminal syndicate has committed violent crimes and used various vehicles to transport illegal drugs. Key syndicate leaders are arrested and convicted. The vehicles are seized in a criminal forfeiture. Selling the vehicles at fire-sale prices is an option. The authorities could, however, repurpose the vehicles and use them in the government's fleet, which would provide a public benefit.

¹⁵² See Strine, *supra* note 150, at 243.

¹⁵³ My proposal is not premised on the bankruptcy court identifying a debtor as a "scarlet-lettered company." Rather, I urge victim and creditor committees to consider the public benefit proposal when they believe it offers an improved recovery outcome.

¹⁵⁴ *Types of Federal Forfeiture*, U.S. DEP'T OF JUST., <https://www.justice.gov/afms/types-federal-forfeiture> [<https://perma.cc/5THG-WFJJ>]. I thank Marshall Huebner for suggesting this analogy.

This simple analogy aligns features of criminal activity in two very distinct spheres but still overlooks a key aspect of mass tort resolution. A general public good is a potential benefit of my proposal, but the primary focus is to compensate those directly harmed by tortious conduct.

A. *Objectives and Key Facets of the Public Benefit Proposal*

At its core, the public benefit proposal formulates a modified reorganization and deferred auction that utilize a public benefit corporation to secure stakeholder buy-in and cleanse tainted assets. The framework has two primary objectives. First, the public benefit proposal must offer a process and timeline to efficiently¹⁵⁵ dispose of scarlet-lettered assets. If successful, there is an increased likelihood that the second objective—a sufficiently funded settlement trust¹⁵⁶—will be realized and avoid a significant number of victims having absolutely no recovery option.¹⁵⁷ As discussed above, mass-restructuring cases to date have provided no financial backstop for a settlement trust that becomes prematurely insolvent. This raises the risk that victims of the same mass tort whose claims are resolved through the same claim aggregation process will experience materially different recoveries based on the temporal characteristics of their respective claims. The public benefit proposal must not allow the timing of when harm manifests be dispositive as to the level of recovery to which a victim is entitled. This second objective addresses disparate treatment across victim classes that include current victims and future victims.¹⁵⁸

There are three key facets to the public benefit proposal that increase the likelihood of fulfilling these primary objectives: allocating the delay

¹⁵⁵ As noted above, for purposes of this Article, a bankruptcy auction is “efficient” if it is unlikely that an alternative choice would produce a higher realized price and increased distribution to creditors. *Supra* note 41.

¹⁵⁶ A sufficiently funded trust should not be construed to mean that all victims receive full compensation for meritorious claims; rather, the phrase should be understood as describing a trust that has sufficient resources to pay all victims the predetermined fractional value of their claims, as established by the plan of reorganization.

¹⁵⁷ A sufficiently funded trust also mitigates the risk of uncompensated future victims arguing that the settlement process did not satisfy procedural due process, claims that, if successful, could threaten to unwind key aspects of a seemingly successful reorganization. *See* Campos & Parikh, *supra* note 135, at 30–31 (explaining how the bankruptcy process is vulnerable to due process claims).

¹⁵⁸ Future victims have been affected by tortious conduct but may not exhibit harm for years or decades. Individuals exposed to asbestos present a good example of this phenomenon, but the dynamic exists in other contexts, including sex-abuse cases. I acknowledge that not all scarlet-lettered bankruptcies will have future victims, but this is always a risk when injuries have material latency periods. This will certainly be an issue in the bankruptcy case of LTL Management, Johnson & Johnson’s talc subsidiary, and cases involving brain cancer stemming from excessive wireless device use. *See* Parikh, *supra* note 18, at 10 (explaining the divergent interests of current and future victims in mass tort cases).

premium to victims, emerging from bankruptcy as a public benefit corporation, and ensuring governance safeguards.

*B. Allocating the Delay Premium to Victims and
Avoiding Prematurely Insolvent Trusts*

My proposal seeks to address the objectives outlined above by creating a delay premium and then allocating funds directly to the victims' trust. Conceptually, creating a reorganized corporation for the public benefit reduces to an acceptable level ex post residual stain risk and defers auctions to a time when bidder discounting no longer precludes assets from realizing fair market value. The public benefit proposal offers a philanthropy shield behind which tainted assets can be cleansed. Over time, the residual stain evaporates, and the new corporation can conduct an auction when the value rebound has been fully realized, ideally within three to five years.

The presence of a delay premium may be underappreciated. Part II discussed research involving the delay premium and how sales of volatile assets create significant discounting. In volatile-asset cases, delaying an auction for one year can increase equity value by over 15%; delaying it two years can increase equity value by over 25%.¹⁵⁹ Shareholders and other parties dependent on auction proceeds can capture one-quarter of a firm's value by simply opposing a rushed sale and advocating for a deferral, assuming the resolution process allows this option.¹⁶⁰ For cases involving tainted assets, the premium could be much larger.

The valuation analysis in *Purdue* offers insight into the potential magnitude of the delay premium. For plan confirmation, a debtor is required to hire third-party professionals to produce a financial analysis that determines the most likely recovery for different creditor classes if the debtor were liquidated.¹⁶¹ These assessments capture three key points (high, medium, and low) in the recovery range.¹⁶² Numerous assumptions underlie these assessments, including that (1) the asset sale is orderly¹⁶³ and designed

¹⁵⁹ See Neyland & St. John, *supra* note 40, at 5.

¹⁶⁰ See *id.*

¹⁶¹ This analysis is necessary for plan confirmation because § 1129(a)(7) of the Bankruptcy Code imposes the "best interests" test, which restricts a court from confirming a plan of reorganization unless the plan provides that each holder of an impaired claim who does not otherwise vote in favor of the plan receives property of a value that is not less than the amount that such holder would receive if the debtor were liquidated. 11 U.S.C. § 1129(a)(7); see PATRICK A. MURPHY, CARRIE V. HARDMAN & DAVID NEIER, CREDITORS' RIGHTS IN BANKRUPTCY § 17:13 (2d ed.).

¹⁶² See *Purdue* Disclosure Statement, *supra* note 122, app. B at Ex. 1.

¹⁶³ In *Purdue*, the assumption was that assets could be liquidated over a period of up to one year. See *id.* app. B at 2 ("The Liquidation Analysis assumes that the Trustee would wind down and monetize the Assets of the Debtors over a twelve-month period . . .").

to secure the highest realized price under the circumstances, and (2) ostensibly all of the corporate assets and litigation claims will be part of the sale.¹⁶⁴

In *Purdue*, AlixPartners prepared this analysis and concluded that a rushed sale of the company would be disastrous for victims, generating no payment to victims in the low-recovery scenario, and virtually no recovery in the middle-recovery scenario.¹⁶⁵ The high-recovery scenario offered an aggregate recovery of only \$699 million.¹⁶⁶ These results were then compared to a valuation analysis of Knoa, the reorganized public benefit company that is expected to emerge from the bankruptcy case.¹⁶⁷ The variance is staggering.¹⁶⁸ Based on Purdue's historical performance, Knoa's future prospects, industry trends, and national and international market dynamics, AlixPartners estimated that approximately \$5.5 billion will be distributed on account of victim claims under the plan.¹⁶⁹ This amount is nearly 800% greater than the likely maximum aggregate recovery on account of those claims in a high-recovery liquidation scenario.¹⁷⁰

Naturally, this analysis is subject to uncertainties and contingencies. Nevertheless, understanding outcome probabilities is extremely useful in financial decision-making. Creditors regularly rely on these types of analyses, bolstering the idea that the assessments have material

¹⁶⁴ See *id.*

¹⁶⁵ See *id.* app. B; Notice of Filing of Debtors' Third Revised Proposed Findings of Fact, Conclusions of Law, and Order Confirming the Eleventh Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors at 41, *In re* Purdue Pharma, L.P., 635 B.R. 26 (Bankr. S.D.N.Y. 2021) [hereinafter *Purdue Debtor's Proposed Findings of Fact*].

¹⁶⁶ See *Purdue Disclosure Statement*, *supra* note 122, app. B, at Ex. 1; *Purdue Debtor's Proposed Findings of Fact*, *supra* note 165, at 41.

¹⁶⁷ On November 18, 2020, Purdue entered into a plea agreement with the Department of Justice that obligates Purdue to reorganize as a public benefit company or an entity with a similar mission. See Debtors' Memorandum of Law in Support of Confirmation of Debtors' Sixth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Debtor Affiliates and Omnibus Reply to Objections Thereto, *In re* Purdue Pharma, L.P., 635 B.R. 26 (Bankr. S.D.N.Y. 2021) [hereinafter *Purdue Memorandum of Law*]. Knoa's ultimate entity form is unresolved. The order confirming Purdue's plan of reorganization was appealed and recently vacated, see Rick Archer, *Purdue Pharma's Ch. 11 Plan is Unraveled on Appeal*, LAW360 (Dec. 16, 2021), <https://www.law360.com/articles/1449669/purdue-pharma-s-ch-11-plan-is-unraveled-on-appeal> [<https://perma.cc/SVZ2-7W73>], but that does not affect the potential benefits of the plan's features. Purdue has appealed the district court's ruling. See Vince Sullivan, *Purdue Ch.11 Appeal Can Go to 2nd Circ., NY Judge Rules*, LAW360 (Jan. 7, 2022), <https://www.law360.com/articles/1453543/purdue-ch-11-appeal-can-go-to-2nd-circ-ny-judge-rules> [<https://perma.cc/G2VL-5AA7>].

¹⁶⁸ See *Purdue Memorandum of Law*, *supra* note 167, at 150.

¹⁶⁹ See *id.*

¹⁷⁰ See *id.*

value. In *Purdue*, victims gave this analysis considerable weight, voting overwhelmingly to approve the plan.¹⁷¹

A successful deferred auction creates a premium that can be allocated to victims through the settlement trust. This structure can avoid a wealth transfer from victims to the fortunate bidder who happens to win a rushed auction. Once these dynamics are understood, there is a strong incentive for victims to seek delay. The premium may not approach the number expected in the *Purdue* bankruptcy, but the need to consider the possibility of this premium is clear.¹⁷²

C. A Corporation for the Public Benefit

As I have written before, “[t]here is a certain level of equitable balance in a company that has done evil being reorganized to solve that evil.”¹⁷³ This idea is a key part of the projections noted above, and why the public benefit model improves value and offers the possibility of a windfall for victims. I argue that a scarlet-lettered company that rejects past criminality and pursues rehabilitation can shed the residual stain. This transformation improves relationships with consumers and investors, mitigating public scorn and social-norm effects. The public benefit model enhances the likelihood of this result by allowing parties to easily impose covenants and other governance safeguards to ensure that management fulfills the restorative and philanthropic objectives that encouraged stakeholder buy-in. As noted above, public benefit companies are policed in a unique way to ensure that they fulfill their missions.¹⁷⁴ I argue that this fact helps assure stakeholders, consumers, and investors that the company has undergone a sincere metamorphosis as opposed to a disingenuous rebranding.¹⁷⁵

1. Windfall Profits

As discussed above, bankruptcy auctions frequently fail to maximize revenue for the bankruptcy estate.¹⁷⁶ This inefficiency diminishes proceeds for creditors. On the other side of this dynamic, the purchaser who has

¹⁷¹ More than 95% of the approximately 120,000 submitted votes were in favor of approving the plan of reorganization. *See id.* at 158; *see also In re Purdue Pharma, L.P.*, 635 B.R. 26, 36–37 (S.D.N.Y. 2021) (noting that all five primary victim groups believed that a *Purdue* sale would produce virtually no recovery for the victims).

¹⁷² The proceeds from the ultimate auction of the public benefit company are not the only funds in the victims’ settlement trust. The trust will invariably be funded by contributions from affiliated entities and insurance companies. Current victims do not have to wait three to five years to begin receiving recoveries from the trust. Proceeds from the auction supplement the trust corpus.

¹⁷³ *See Parikh, supra* note 114, at 71.

¹⁷⁴ *See supra* Section II.B.

¹⁷⁵ *See Smith & Malone, supra* note 144, at 555.

¹⁷⁶ *Supra* Section I.A.

secured assets at a below-market price is well-situated to enjoy windfall profits. In a typical case, the value rebound occurs when an auctioned company realizes the fair market value it enjoyed prior to an episodic value decline. Further along that spectrum, the “windfall” occurs when value continues rising to an unpredicted level, yielding an unexpected profit for shareholders. The public benefit proposal attempts to shift this windfall—to the extent one materializes—to victims, the new owners of the reorganized company.

Going back to a sin-company example, the Station Casinos asset sale captures the advantages this equity position presents. The casino group that would ultimately become Station Casinos was founded by Frank Fertitta Jr. in 1976. Frank’s two sons partnered with Colony Capital to take the business private in 2006.¹⁷⁷ In the throes of the Great Recession and facing multiple exogenous market factors, Station Casinos filed for bankruptcy in 2009 with \$6.5 billion of debt.¹⁷⁸ The company valued its casino properties at \$5.7 billion, but these assets were certainly volatile, and in an industry that had been decimated by consumers shifting away from gaming activities.¹⁷⁹ The debtors moved for a quick sale of the enterprise. Casino assets were auctioned in conjunction with a plan of reorganization.¹⁸⁰ The Fertitta brothers—the existing owners—were the winning bidders, leading a group of insiders¹⁸¹ who contributed a mere \$772 million for the debtor’s valuable assets.¹⁸²

Just five years after the sale, the Station Casinos enterprise was worth \$3.5 billion, almost five times the realized price from the bankruptcy auction.¹⁸³ On April 26, 2016, the Fertittas took Station Casinos public under

¹⁷⁷ Joy Noel, *Station Casinos Look to Sell Part of Their 380-Acre Development Land Sites*, BEST US CASINOS (Feb. 10, 2020), <https://www.bestuscasinos.org/news/station-casinos-look-to-sell-part-of-their-380-acre-development-land-sites/> [<https://perma.cc/K9CX-VHEC>].

¹⁷⁸ *See id.*

¹⁷⁹ *See id.*

¹⁸⁰ *See* Disclosure Statement to Accompany Joint Chapter 11 Plan of Reorganization for Station Casinos, Inc. and Its Affiliated Debtors (June 15, 2010), *In re* Station Casinos, Inc., No. BK-09-52477 (Bankr. D. Nev. June 15, 2010).

¹⁸¹ The other primary equity owners were the company’s main secured lenders. *See* Julie Triedman, *After Two Rocky Years, Station Casinos Exits Bankruptcy*, AMLAW DAILY (June 20, 2011, 5:25 PM), <https://amlawdaily.typepad.com/amlawdaily/2011/06/stationcasinosexit.html> [<https://perma.cc/USS9-97ZK>].

¹⁸² *See Judge OKs Station Casinos Bankruptcy Exit Plan*, REUTERS (Aug. 27, 2010, 3:48 PM), <https://www.reuters.com/article/stationcasinos-bankruptcy/judge-oks-station-casinos-bankruptcy-exit-plan-idINN2710205520100827> [<https://perma.cc/F3VT-S6N2>].

¹⁸³ Christopher Palmeri, *Fertitta Brothers Said to Weigh Share Sale for Station Casinos*, BLOOMBERG (May 27, 2015, 6:27 PM), <https://www.bloomberg.com/news/articles/2015-05-27/fertitta-brothers-said-to-weigh-share-sale-for-station-casinos> [<https://perma.cc/BF9N-JECM>]; Howard Stutz,

the name “Red Rock Resorts,” and captured a windfall.¹⁸⁴ In some respects, the Fertittas established their own deferred auction before selling their casino empire to the general public. In late 2021, Red Rock Resorts enjoyed a \$6 billion market capitalization.¹⁸⁵

During the Great Recession, many creditors—primarily corporate bondholders—demonstrated risk aversion by willingly accepting a diminished upfront payout in distress situations.¹⁸⁶ None of the key creditors in the Station Casinos case objected to the asset sale to the Fertittas.¹⁸⁷ But keep in mind that these parties enjoy this flexibility because they have invariably hedged their exposure, secured insurance, purchased the debt at a significant discount, or installed other safety nets to minimize the impact of losses.¹⁸⁸ Sophisticated creditors are prepared to absorb the speed discount and frequently do. But victims in scarlet-lettered bankruptcies are not so lucky.

An equity position in a reorganized company undoubtedly brings risks in addition to benefits for mass tort victims. I argue, however, that the risks are manageable. Through the bankruptcy process, the debtor’s capital structure has been heavily scrutinized, and many systemic issues are resolved. These factors, coupled with the governance safeguards outlined below and the staggering level of discounting in scarlet-lettered auctions, justify the idea of victims waiting for a value rebound with the possibility of a windfall.¹⁸⁹

2. *Securing Stakeholder Buy-In*

As noted in Part II, scarlet-lettered bankruptcies are unique in a number of ways. One distinguishing characteristic is the creditor body involved. The

Station Casinos’ Corporate Name Will Be Red Rock Resorts After IPO, L.V. REV.-J. (Jan. 21, 2016), <https://www.reviewjournal.com/business/station-casinos-corporate-name-will-be-red-rock-resorts-after-ipo/> [<https://perma.cc/WHY7-AANS>].

¹⁸⁴ Palmeri, *supra* note 183; Stutz, *supra* note 183.

¹⁸⁵ *Market Capitalization of Red Rock Resorts (RRR)*, COMPANIESMARKETCAP (July 2022), <https://companiesmarketcap.com/red-rock-resorts/marketcap/> [<https://perma.cc/N6P9-RQKF>].

¹⁸⁶ Unsecured bondholders in the Station Casinos case did receive a 15% equity stake. Triedman, *supra* note 181.

¹⁸⁷ See John G. Edwards, *Station Casinos Receives OK for Sale*, L.V. REV.-J. (Aug. 6, 2010, 9:44 AM), <https://www.reviewjournal.com/business/station-casinos-receives-ok-for-sale/> [<https://perma.cc/3QZ4-6CPE>].

¹⁸⁸ See generally Dalia T. Mitchell, *From Vulnerable to Sophisticated: The Changing Representation of Creditors in Business Reorganizations*, 16 N.Y.U. J.L. & BUS. 123, 168 (2019) (describing how sophisticated creditors have tools to “take matters to their hands” to protect their financial interests).

¹⁸⁹ The Bankruptcy Code’s original design attempted to include mass tort victims in future asset appreciation, but that statutory design failed in practice. See Parikh, *supra* note 18, at 48 (discussing the intent of § 524(g) and explaining how parties easily circumvented the equity allocation that was to be afforded to victims). The public benefit proposal revives this idea.

typical scarlet-lettered bankruptcy will involve current and future victims, state governments, and federal agencies. These are not the creditors seen in most large Chapter 11 cases. They bring a distinctive set of demands, and debtors need their support to avoid liquidation and secure the various prizes the process offers.¹⁹⁰

The public benefit proposal is premised on a deferred auction. The public benefit corporation that emerges from the case allows victims to capture the value rebound by providing a philanthropy shield behind which a tainted business can be cleansed. In a traditional reorganization, the debtor emerges as a new corporation. But this change could be perceived to be a mere rebranding, which would not lift residual stains for scarlet-lettered companies. Without a value rebound, a deferred auction creates the worst option for scarlet-lettered companies.

The public benefit model must enhance the likelihood of stakeholder buy-in. As explored in Section III.D, *infra*,¹⁹¹ state law allows for the imposition of rigorous governance safeguards that ensure that new directors maintain fidelity to the corporation's (1) financial goal of ultimately regaining enough value to sufficiently fund the victims' trust; and (2) societal goal of assisting the direct and indirect victims of the debtors' tortious conduct. Some may question how much value victims would place on governance safeguards, but the public benefit model's effect was clear in *Purdue*. In that case, the five key creditor groups representing a host of victims all stressed that settlement was possible because of the shared vision they had with the debtor to provide a mechanism to help direct and indirect victims of the opioid crisis and a belief that this vision could actually be fulfilled.¹⁹²

Bankruptcy's collaborative design also requires bankruptcy court buy-in. The court must approve the ultimate resolution framework and various forms of essential relief, including complicated nonconsensual, third-party liability releases and a modified automatic stay protecting nondebtor parties.¹⁹³ The support of victim groups plays a large role in these cases because the bankruptcy judge will give considerable weight to the

¹⁹⁰ *Supra* note 144 and accompanying text.

¹⁹¹ *See infra* Section III.D.

¹⁹² *See In re Purdue Pharma, L.P.*, 635 B.R. 26, 37 (S.D.N.Y. 2021) (noting that the five primary victim groups that had voted overwhelmingly in favor of the debtor's plan had been persuaded by the "tremendous public benefit that will be realized by implementing the Plan's many forward-looking provisions").

¹⁹³ *See id.*

preferences of this sympathetic group in making key rulings in the case, including the decision to confirm the debtor's proposed resolution.¹⁹⁴

D. Governance Safeguards

The delay premium and stakeholder buy-in are both contingent on the new public benefit corporation fulfilling financial and societal goals. The proposal's third key facet involves relying on public benefit covenants and statutes to ensure fidelity to the new corporation's mission.

Delaware state law¹⁹⁵ allows the bankruptcy court and other stakeholders to impose rigorous governance safeguards on public benefit companies. This feature is particularly important for scarlet-lettered companies because the debtor has already committed significant transgressions that may be attributed to corrupt executives but could also be the byproduct of operating in an industry where unethical conduct has been normalized.

As noted above, a public benefit corporation's certificate of incorporation can explicitly delineate stakeholders that directors must consider in decision-making processes.¹⁹⁶ Even without this feature, the Delaware code requires directors to balance shareholders' pecuniary interests with the best interests of all other groups who are materially affected by the corporation's conduct.¹⁹⁷ Delaware law allows planners to demand¹⁹⁸ a high level of fidelity to the overarching public benefit mission.¹⁹⁹ Fiduciary duties in this context are not explicitly defined, but directors are required to balance wealth maximization against the interests of corporate

¹⁹⁴ See *In re Purdue Pharma, L.P.*, 633 B.R. 53, 61 (Bankr. S.D.N.Y. 2021) (explaining the importance of victim groups' overwhelming support to the court's decision to confirm the plan).

¹⁹⁵ Delaware state law and court system are the preeminent authorities on corporate law and enjoy a unique level of familiarity with institutional investors, corporate managers, and other intermediaries. See Strine, *supra* note 150, at 243. This Section will assume that the reorganized public benefit corporation will incorporate in Delaware, but the conclusions reached hold regardless of the state of incorporation. See Mark J. Loewenstein, *Benefit Corporation Law*, 85 U. CIN. L. REV. 381, 381 (2017) (noting that benefit-corporation legislation "is based, to a greater or lesser extent, on Model Legislation drafted for B Lab Company").

¹⁹⁶ *Supra* note 149 and accompanying text.

¹⁹⁷ See DEL. CODE ANN. tit. 8, § 365(a) (2022). Under the code, a public benefit "means a positive effect (or reduction of negative effects) on 1 or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders) including, but not limited to, effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature." *Id.* § 362(b).

¹⁹⁸ Section 367 affords shareholders an explicit right to bring derivative actions, even though their for-profit brethren must rely on Delaware common law. See *id.* § 367.

¹⁹⁹ For example, a pharmaceutical company focused on maximizing public health rather than profits would be transformative in addressing the litany of problems that plague the U.S. healthcare marketplace. The same broad societal benefits could also be realized in other industries.

stakeholders.²⁰⁰ Section 365(a) of the Delaware Code is explicit on this point, and section 365(b) arguably imposes liability for decisions that are merely unreasonable—a meaningful departure from the for-profit construct.²⁰¹

Underneath this umbrella, the ultimate design has relatively simple mechanics. The new public benefit corporation (“NewCo”) should acquire the profitable assets owned by the debtor prior to bankruptcy.²⁰² NewCo’s certificate of incorporation should mandate that directors consider current and future mass tort victims as well as other stakeholders that the court orders. Governing documents can also dictate how NewCo will operate. For example, in *Purdue*, the governing documents provide for the creation of a new public benefit company called Knoa that must (1) fundamentally operate for the public benefit, (2) consider long-term public health interests relating to the opioid crisis in its decision-making processes, and (3) employ transparent and sustainable management practices.²⁰³ Knoa must make medicines available to treat opioid addiction and reverse opioid overdoses.

Flexibility under Delaware state law allows the court-approved plan to dictate how directors will be selected and apportion representative power across victim groups.²⁰⁴ The plan can also dictate director qualifications, which could be relevant depending on the industry in which the new entity will operate. Adding a further level of protection, the plan can require that a monitor be appointed to act as a type of independent board overseeing the directors. This monitor is an extension of the court and should be tasked with reviewing NewCo’s compliance with its corporate covenants and applicable bankruptcy court orders. The monitor selection process can be established by the debtor and approved by the court after consultation with victim groups.²⁰⁵

Finally, the governing documents should establish a terminal date. After all, the proposal is built upon the idea of a deferred auction designed to capture a value rebound. NewCo’s directors could be afforded the discretion to seek an auction within some set period of time, perhaps three to

²⁰⁰ See Michael B. Dorff, *Why Public Benefit Corporations?*, 42 DEL. J. CORP. L. 77, 96 (2017).

²⁰¹ See *id.* at 96–97.

²⁰² We can look to the Purdue bankruptcy for guidance. See Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors, *In re Purdue Pharma, L.P.*, 635 B.R. 26 (Bankr. S.D.N.Y. 2021) [hereinafter *Purdue’s Twelfth Amended Plan*]. As noted above, the order confirming the plan of reorganization was appealed and recently vacated, see *supra* note 167, but that does not affect the potential benefits of the plan’s features.

²⁰³ *Purdue’s Twelfth Amended Plan*, *supra* note 202, at 22–23 (defining “NewCo Governance Covenants”).

²⁰⁴ *Supra* notes 195–196 and accompanying text.

²⁰⁵ Naturally, the process should not mirror the deficient FCR selection process. See Parikh, *supra* note 18, at 36–39.

five years. In the alternative, a fixed sell-by date can be established with the possibility of a one-year extension to afford directors some flexibility. Governing documents should provide for the distribution of proceeds, most of which should be directed to victims or settlement trusts.²⁰⁶

All these statutory provisions work together to encourage victim groups and other stakeholders to take a leap of faith and support a restructuring effort premised on a longer-than-expected commitment to a mass tort villain.

CONCLUSION

There is a scholarship vacuum at the intersection of aggregate litigation and bankruptcy, but this is also the epicenter for the most meaningful and challenging legal issues today. Throughout the last decade, aggregate litigation scholarship ignored the possibility that bankruptcy represented an optimal resolution process. Mass-restructuring cases in the last few years highlight the consequences of that oversight: mass tort victims face exploitation. My public benefit proposal is one step in an effort to address this wrong by enhancing victim recoveries.

²⁰⁶ The potential value of this model does not necessarily end at the auction, though. A Delaware public benefit corporation is not subject to the *Revlon* ruling, which holds that “concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.” *See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986). This means that directors of NewCo would not be obligated to sell the corporation to the bidder offering to pay the highest price. In selecting a winner, directors could consider whether the buyer planned to continue the corporation’s lofty mission. *See Strine, supra* note 150, at 245–46.

